

Steel Brothers and Co. Ltd.

Vs

Commissioner of Income-Tax

Civil Appeal No. 217 of 1955

(N. H. Bhagwati, S. K. Das, J. L. Kapur JJ)

17.05.1957

JUDGMENT

BHAGWATI, J. -

This appeal with special leave is directed against a judgment and order of the High Court of Judicature at Calcutta delivered on a reference by the Income-tax Appellate Tribunal (Calcutta Bench) under section 66(1) of the Indian Income-tax Act (XI of 1922) hereinafter referred to as "the Act" whereby the High Court answered the referred question in the negative.

The facts leading up to this appeal may be shortly stated as under :

Prior to November 29, 1928, Steel Bros. & Co. Ltd. (hereinafter referred to as "Steels") and Ellerman's Arracan Rice and Trading Co. Ltd. (hereinafter referred to as "Ellermans") carried on trade in Burma rice and/or its by-products in Burma in London and elsewhere inter alia through Burma and London Bullenger Rice Pool and the New General Rice Co. Ltd. Apart from the selling of rice, both these companies had rice milling machines and produced rice from paddy. There was another company known as the Burma Co. Ltd. (hereinafter referred to as "Burma"). This company also had a few rice mills. It never purchased paddy or sold rice. All the shares of this company were held by Steels, who were also its managing agents.

On or about November 29, 1928, an agreement was entered into between the Steels, Burma and Ellermans to provide for the amalgamated working of the Burma rice business in Burma and London of all the three companies under the management of Steels. The combined business of Steels, Burma and Ellermans was referred to therein as "the Combination". All stocks of Burma rice and by-products in hand at 30th November, 1928, were excluded from this agreement and remained the property of the individual owners to be disposed of by them as they thought fit and the entire business in Burma hitherto carried on by Ellermans was to be taken over and managed by Steels as from 1st December, 1928, and conducted from Steels' offices in London, Rangoon and other Burma branches in Steels' name solely and in conjunction with the whole of the rice business of all descriptions of Steels and Burma and Steels were to conduct the said business in such manner as they in their absolute discretion should think fit. The profit or loss of the business of the Combination carried on at the under mentioned places was to be shared by and divided between Steels and Ellermans in the following ratios :

Rangoon Bassein Akyab Moulmein Steels & Burma 68% 68% 68% 72% Ellermans:
32% 32% 32% 28%##

The rice mills belonging to Burma, viz., Burma Upper Kanungtoe Mill in Rangoon, Burma Mill in Bassein and Burma's Martaban Mill in Moulmein, were to be worked by the Steels for the purpose of the Combination (clause 4a). The agreement was to take effect as from 1st December, 1928, and could be terminated on 30th November, 1930, or on any subsequent 30th November, by and party giving notice to that effect to others not later than the preceding 1st August (clause 12). The agreement was signed and the common seals of Steels and Ellermans were affixed thereto and it was also signed by one James Kilgour Michie for and on behalf of Burma.

In connection with the assessments for the assessment years 1943-44 and 1944-45 the Combination (which is hereinafter referred to as "the assessee") made applications to the Income-tax Officer under section 26A of the Act for registration of their partnership said to be constituted of Steels and Ellermans. These applications were signed by the Steels and Ellermans only and were supported by a copy of the agreement dated November 29, 1928, which was relied upon as the instrument of partnership of which registration was sought.

By two separate orders dated March 19, 1948, and March 31, 1949, the Income-tax Officer, District V, Calcutta, refused registration of the partnership on the ground (i) that the partnership was not constituted of Steels and Ellermans only but was constituted of those two parties and a third party, viz, Burma, and that the partnership deed did not specify the shares of the said three partners and (ii) that the loss arising during the previous year had not been properly allocated proportionately to the said three partners the whole of the loss falling to the shares of Steels and Burma having been borne by Steels only.

The assessee carried an appeal before the Second Additional Appellate Assistant Commissioner of Income-tax, "A" Range, Calcutta, who upheld the orders of the Income-tax Officer on the grounds that the application for registration was signed by two partners, Steels and Ellermans, whereas the partnership deed showed that it was a partnership of three partners and that the individual shares of Steels and Burma were not shown separately.

The assessee preferred an appeal to the Income-tax Appellate Tribunal (Calcutta Bench) and by its order dated the 20th February, 1951, the Tribunal held that although the agreement entered not into on November 29, 1928, showed that the three companies would carry on the whole of their Burma rice business on amalgamation, on an examination of the agreement it would appear that the companies which formed the partnership were really Steels and Ellermans; and Burma which was a hundred per cent. subsidiary of Steels had hardly anything to do with the Combination. In its order the Tribunal observed :

"In order to determine whether there was a partnership we have to look into the surrounding circumstances also under section 6 of the Partnership Act and reading the document as a whole and considering the fact that it was drawn up in 1928, and also taking into account the profit and loss account of the Burma Co., for the years ending November, 1941, November, 1942, and November, 1943, we think that the partnership was really between Steels and Ellermans. Burma is bracketed with Steels in paragraph 3(a) in a broad sense as Steels were holding all the shares of Burma. We are therefore of opinion that the deed is a proper deed and should be registered."

Upon the application of the Commissioner of Income-tax, West Bengal (the respondent herein), the Tribunal stated a case and referred the following question of law to the High Court for its decision under section 66(1) of the Act :

"Whether on a proper construction of the deed of agreement dated 29th November, 1928, and having regard to the relevant facts and circumstances of the case, the Tribunal was right in holding that the partnership was really between Steels and Ellermans and that, therefore, registration should have been allowed under section 26A of the Indian Income-tax Act."

The reference was heard by the High Court and the High Court answered the referred question in the negative. The High Court was of the opinion that on a true construction and effect of the agreement and particularly having regard to the recital in the agreement and the provisions contained in clauses 1, 3(a), 12 and 14, thereof, the partnership was a partnership of the three companies and as the applications were not made by the said three companies and the deed of partnership did not specify their respective shares, the registration of the partnership was rightly refused.

The assessee applied for a certificate of fitness under section 66A(2) of the Act which was, however, refused by the High Court with the result that the assessee applied for and obtained from this court special leave to appeal under article 136 of the Constitution.

The sole question that arises for our determination in this appeal is whether on a proper construction of the agreement dated 29th November, 1928, and having regard to the facts and circumstances of the case the applications by the assessee for the registration of the partnership showing Steels and Ellermans as the only partners thereof (with their specific shares set out as against each of them and signed only by them) were rightly refused by the Income-tax Officer.

Section 26A of the Act provides :

"(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 in force relating to income-tax or 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."

Rule 2 of the Indian Income-tax Rules, 1922, prescribes :

"Any firm constituted under an instrument of partnership specifying the individual shares of the partners may, under the provisions of section 26A of the Indian Income-tax Act, 1922,.....

Such application shall be signed by all the partners (not being minors) personally, or in the case of a dissolved firm by all persons (not being minors) who were partners in the firm immediately before dissolution and by the legal representative of any such partner who is deceased....."

In order that an application for registration be entertained by the Income-tax Officer and the partnership registered for the purpose of the Act, it is necessary that the application should be signed by all the partners of the firm and should specify the individual shares of the partners. Unless that is

done it would not be competent to the Income-tax Officer to entertain the application and it would not be obligatory upon him to register the partnership for the purpose of the Act. The question, therefore, that falls to be determined is whether under the agreement dated 29th November, 1928, Steels and Ellermans who were the signatories to the applications for registration were the only two partners in the Combination or there was also a third partner along with them, viz., Burma, which even though it was a party to the agreement had no individual share specified in the profit or loss of the Combination. It was rightly conceded by the learned counsel for the appellant that if on a true construction of the agreement dated 29th November, 1928, and having regard to the relevant facts and circumstances of the case the court came to the conclusion that Burma was in fact a partner in the Combination along with Steels and Ellermans the applications for registration of the partnership which were signed by Steels and Ellermans only and which specified their individual shares in the ratios set out in clause 3(a) of the agreement were not in accordance with the provisions of section 26A of the Act and rule 2 of the Indian Income-tax Rules, 1922, inasmuch as neither had Burma signed the same nor was any individual share of Burma specified in clause 3(a) of the agreement.

The determination of this appeal, therefore, turns on the true construction of the agreement dated 29th November, 1928, regard being had to the relevant facts and circumstances of the case. The relevant facts and circumstances of the case find their place in the referred question as framed and were also sought to be imported under section 6 of the Indian Partnership Act, 1932, which provides :

"6. Mode of determining existence of partnership. - In determining whether a group of persons is or is not a firm, or whether a person is or is not a partner in a firm, regard shall be had to the real relation between the parties, as shown by all relevant facts taken together."

The facts and circumstances which were thus sought to be relied upon by the appellant were : (i) that all the shares of Burma were owned by the Steels, (ii) that according to the findings of the Tribunal Burma never purchased paddy or sold rice, (iii) that no share of the profits of the Combination had ever been paid to or received by Burma and (iv) that in the carrying out of the agreement the only earnings of Burma had been by way of milling hire paid by Steels to Burma. We shall at the appropriate place consider the bearing of these facts and circumstances on the question arising for our determination.

Turning now to the agreement dated 29th November, 1928, we find in the first instance that it is an agreement entered between three parties, viz., Steels, Burma and Ellermans, to provide for the amalgamated working of the Burma rice business in Burma and London of Steels, Burma and Ellermans under the management of Steels. The entire business in Burma rice hitherto carried on by Ellermans is to be taken over and managed by Steels as from 1st December, 1928, and conducted from Steels' offices in London, Rangoon and other Burma branches in Steels' name solely and in conjunction with the whole of the rice business of all descriptions of Steels and Burma. Steels are to conduct the said business in such manner as they in their absolute discretion shall think fit. The combined business of Steels, Burma and Ellermans is therein referred to as "the Combination" (clause 1). At the end of each accounting year the profit or loss of the business of the Combination carried on at the various places therein mentioned is to be shared by and divided between Steels and Ellermans in the following ratios :

Rangoon Bassein Akyab Moulmein Steels & Burma Having : 68% 68% 68%
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respectively (clause 3a). The accounts after being signed in the manner therein mentioned are to be accepted as final and conclusive and binding on Steels and Ellermans and from the accounts of each year a profit and loss account is to be prepared in London and such account is to be final and conclusive and binding on all the parties, viz., Steels, Burma and Ellermans (clause 3d). A restriction is imposed on Steels, Burma and Ellermans against hiring out to any other parties of the properties owned by them or the user thereof by the respective owners for any purpose without the previous consent of Steels (clause 4a). Steels' and Burma's existing Rangoon fleet or rice cargo boats, motor barges and towing launches also such of Ellermans towing launches as may be considered necessary for the purpose of the Combination are to be employed for such purposes but remain the property of the respective owners (clause 6). All bonuses paid to any member of the staff for passing language examination, the cost of furlough passages to and from Europe for all members of Steels, Burma and Ellermans staffs employed for the purpose of the Combination whose leave is due and taken during the period of the agreement and the cost of medical attendance to which Steels, Burma and Ellermans staff employed for the purpose of the Combination are entitled under their respective agreements are chargeable to the Combination (clause 7). All Bullenger Settlements are to be for account of the Combination and are to be embodied in the Combination P and L a/c for distribution in the ratios laid down in clause 3 thereof (clause 10). The agreement is to come into effect on the 1st December, 1928, and can be terminated on 30th November, 1930, or any subsequent 30th November, by any party giving notice to that effect to the others not later than the preceding 1st August (clause 12). In the event of any dispute arising out of or in relation to the agreement other than a dispute for the settlement of which specific provision has been therein made, the same is to be decided by arbitration in accordance with the provisions of the Arbitration Act, 1889, (clause 13). It is further declared that in entering into the agreement and making the arrangements thereby contemplated, the parties intend to work their respective businesses jointly and give mutual assistance to each other and secure greater economy in working (clause 14). The agreement is signed not only by Steels and Ellermans but also by one James Kilgour Michie for and on behalf of Burma.

The clauses of the agreement hereinabove set out would, if there was nothing more, spell out a partnership between the Steels, Burma and Ellermans. The relationship which has been brought into existence between the three parties is a relationship between partners who have agreed to share the profits of a business carried on by all or any of them acting for all within the meaning of the definition of partnership given in section 4 of the Indian Partnership Act, 1932. Even if the definition of partnership which was contained at the relevant date in section 239 of the Indian Contract Act (IX of 1872) be taken into account, the relationship between the parties is one which subsists between partners who have agreed to combine their property, labour and skill in the business of the Combination and to share the profits thereof between them. It is however pointed out on behalf of the appellant that there are several clauses in the agreement which confer rights on Ellermans which rights are not conferred on Burma and they are :

- (1) The right to be fully advised of the progress of the business from time to time and to have due consideration given to any suggestions or observations which they may from time to time make in reference thereto (clause 1).
- (2) The right to have the accounts made up in Burma for the year ending 30th November, 1930, and for any subsequent year audited by a firm of chartered accountants in Burma designated for the purpose by Steels if a request in writing is received by Steels in London from them before the first November, immediately preceding the commencement of the period covered by such accounts; the right to

inspect all accounts and also to receive a copy of the accounts (clause 3d).

(3) The right of their superintending engineers along with those of the Steels, before any mills or other articles are taken over by Steels from any party to the agreement for the purposes of the Combination to satisfy themselves that all are in efficient working order and also to decide whether any item of expenditure shall be classed as repairs or renewals (clause 4c).

(4) A similar right given to their superintending engineers to decide what mills stores are likely to be required for purposes of the Combination and to fix the current market value thereof (clause 4e).

(5) The right to have assurance that the mills owned by them shall get a fair share of all paddy landed and that the mills taken over for the purposes of the Combination will be worked as far as possible to full capacity (clause 4f).

(6) The right to refer matters under sub-clauses (c) and (e) of clause 4 to arbitration (clause 5).

(7) The right of their superintending engineers along with those of the Steels to satisfy themselves that the cargo boats, motor barges and towing launches of all parties employed for the purposes of the Combination are in efficient working order (clause 6).

(8) The right to the utilization of the finance provided by them (clause 11a).

(9) The right to the use of their bankers in connection with bills and drafts (clause 11b).

(10) The right to have their London office drawn upon for a fair share of clean drafts (clause 11c)

(11) A specific provision made in clause 14 for the protection of their interests.

These are specific provisions made in favour of Ellermans under the terms of the agreement none of which obtains so far as Burma is concerned. It is therefore urged that Burma could not be a partner along with Steels and Ellermans in the Combination.

It has, however, to be noted that Burma was a subsidiary company of the Steels and all the hundred per cent. shares of Burma were owned by the Steels. Steels were moreover the managing agent of Burma. The relationship between Steels and Burma was thus a relationship between a parent company and a subsidiary company and even though in law they were separate entities they were in reality one and the same. There was no conflict of interests at any time between Steels and Burma, and Steels who were the managing members of the Combination were expected not only to look after their own interests but also the interests of Burma. The Ellermans on the other hand were strangers who became members of the partnership along with Steels and Burma. They had to be given certain rights in order to protect their interests as against Steels and Burma. It was not necessary under the circumstances to provide any special rights of this nature in favour of Burma and the fact that no such rights were given to Burma as were given to Ellermans does not lead to the conclusion that Burma was not a partner along with Steels and Ellermans in this Combination. It

would have been superfluous to provide these rights to Burma for the simple reason that they would have been exercised only by Steels who were its managing agents. If as a matter of fact the Steels were the managing members of the Combination they would be doing everything necessary for the protection not only of their own interest but also the interests of Burma and if that was so there was no need at all to provide any separate rights for Burma of the nature which were provided for Ellermans.

If this position is borne in mind the provision in clause 3a of the agreement also is easy to understand. So far as the partnership was concerned a joint share between Steels and Burma was reserved by bracketing Steels and Burma together and providing for the distribution of profit or loss of the business of the Combination in the ratios therein specified as between Steels and Burma on the one hand and Ellermans on the other. These ratios were also suggestive as providing roughly two shares between the Steels and Burma bracketed together and one share for the Ellermans who were the third partner in the Combination. As between Steels and Burma however it was not thought necessary to distribute the profits any further for the simple reason that whatever profits went to Burma would ultimately find their way to Steels - the Steels having owned all the 100 per cent. shares of Burma. Even though this distribution of the shares in the ratios mentioned above was thus provided in clause 3a of the agreement (reserving for Steels and Burma jointly and for Ellermans individually the particular shares in the profit or loss as therein specified), clause 3 went on to provide that the profit or loss of the Combination will be shared by and divided between Steels and Ellermans. The Steels were to receive whatever came to the joint shares of the Steels and Burma and what they did thereafter was purely a matter between them and Burma. Burma agreed under clause 3a agreement to have a joint share in the profit or loss of the Combination along with Steels and also agreed that whatever came to their joint share should be received by the Steels and that is why clause 3a provided for the actual division of the profit or loss between the Steels and Ellermans. The fact that no provision was made for the receipt of any share by Burma in the profit or loss falling to the joint share of Steels and Burma does not necessarily mean that Burma had no share in the Combination. There is no ambiguity whatever, nor is there any mystery or mistake in the provision contained in clause 3a in regard to the distribution of the profit or loss of the Combination. As a matter of fact, clause 3a definitely points to the conclusion that Burma was a partner along with Steels and Ellermans in the Combination.

On a true construction of the agreement dated 29th November, 1928, we have, therefore, come to the conclusion that Burma was a partner along with Steels and Ellermans in the Combination and had a joint share with the Steels in the profit or loss of the Combination. It was entitled to terminate the partnership by giving notice to the other partners as specified in clause 12 of the agreement. It had also a right to refer all the disputes arising between the partners to be decided by arbitration in accordance with the provisions of the Arbitration Act, 1889. There was a sharing of the profit or loss of the business of the Combination and there was also an agency in so far as Steels were to manage and carry on the business on behalf of all the partners of the Combination. Thus all the ingredients of partnership were satisfied and it is futile to urge that the agreement was a hybrid document which was a tripartite agreement so far as the business of the Combination was concerned and was a partnership agreement only between two partners, viz., Steels and Ellermans. There is not the slightest doubt whatever that Burma was a partner with Steels and Ellermans in the business of the combination and the partnership which was entered into under the terms of agreement was a partnership between three partners, viz., Steels, Burma and Ellermans.

Having regard to the above, it would be unnecessary for us to consider whether there were facts and circumstances in the case which would go to detract from this position and show that even though

ostensibly there was a partnership of three parties, viz., Steels, Burma and Ellermans, in reality the Combination consisted of only two partners, viz., Steels and Ellermans, and Burma was merely a confirming party thereto. We shall however consider the facts and circumstances on which particular reliance has been placed on behalf of the appellant in view of the fact that the referred question has been framed in a manner which requires the consideration of such facts and circumstances of the case.

Adverting to these facts and circumstances, we find that there is nothing in them which runs counter to the conclusion which we have reached above. The fact that all the shares of Burma were owned by the Steels really explains why Burma was not given any specific rights like Ellermans in the agreement dated 29th November, 1928, for the protection of its interests, inasmuch as the interests of Burma were absolutely safe in the hands of the Steels and no provision was required to be made for the protection of Burma's interests as such. The fact that Burma never purchased paddy or sold rice is also devoid of significance because Burma had contributed its properties to the Combination and there could not be any independent purchase of paddy or sale of rice by Burma after the Steels assumed and carried on the management of the business of the Combination. The circumstance that no share of the profits of the Combination had ever been paid to or received by Burma has been already explained above. The Steels and Burma had a joint share amongst themselves which was roughly two-thirds of the total profit or loss of the Combination. All the hundred per cent. shares of the Burma were owned by Steels and if as a result of internal arrangement between themselves the Steels appropriated to themselves all the profits which came to the Steels and Burma jointly in the Combination, that was certainly not a circumstance which would go to show that Burma was in fact no partner in the Combination. The further circumstance that in the carrying on of the agreement, the only earnings of Burma had been by way of milling hire paid by Steels to Burma, again is of no consequence. So far as the books of account of the Combination were concerned it does not appear that there was any payment by the Combination to Burma at all of the milling charges and if by some arrangement between Steels and Burma, Steels actually did pay to Burma a sum of money out of the profits earned in the joint share of the Steels and Burma, that again was a matter of internal arrangement between Steels and Burma and such payment by the Steels could not detract from the position of Burma as a partner in the Combination if the terms and conditions of the agreement dated 29th November, 1928, did not spell out anything to that effect. These facts and circumstances are of no significance whatever and do not help the appellant in the contention which has been urged on its behalf that the real position of Burma was that of a party to the combine but not that of a partner in the Combination. There is no justification whatever, in our opinion, for contending that the agreement dated 29th November, 1928, was a composite agreement which could be divided into two parts, viz., (1) a tripartite agreement between the members of the Combination and (2) an agreement of partnership between Steels and Ellermans only, Burma being merely a confirming party to it in so far as a part of its assets were thrown into the Combination.

The answer given by the High Court to the referred question in the negative was accordingly correct and this appeal will be dismissed with costs.

Appeal dismissed.

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