

R. C. Mitter & Sons

Vs

Commissioner of Income-Tax, Calcutta

D. C. Auddy & Brothers

Vs

Commissioner of Income-Tax, Calcutta

C.A. No. 389 of 1957

(B. P. Sinha, J. L. Kapur, M. Hidayatullah JJ)

15.04.1959

JUDGMENT

SINHA, J. -

The common question of law arising in these two appeals on certificates of fitness granted by the High Court of Calcutta under section 66A(2) of the Indian Income-tax Act, 1922, is the effect and scope of the words "constituted under an instrument of partnership" in section 26A of the Income-tax Act, which, in the course of this judgment, will be referred to as the Act.

The facts of the two cases, leading up to these appeals, though not dissimilar, are not identical. They are, therefore, set out separately.

In Civil Appeal No. 85 of 1957, Messrs. R. C. Mitter and Sons, 54, Rani Kanto Bose Street, Calcutta, claim to be a firm said to have been constituted in April, 1948, with four persons whose names and shares in the net profits of the partnership business are stated to be as under :

- (a) Ramesh Chandra Mitter - 40 percent. of the nett profits.
- (b) Sudhir Chandra Mitter - 30 percent. of the nett profits.
- (c) Sukumar Mitter - 20 percent of the nett profits.
- (d) Sushil Chandra Mitter - 10 percent. of the net profits.

The firm intimated its bank, the Bengal Central Bank, Limited, (as it then was), of the constitution of the firm as set out above, by its letter dated April 15, 1948. The letter also stated that a partnership deed was going to be drawn up and executed by the partners aforesaid, and that the deed so drawn up will be forwarded to the bank in due course. Though the firm is said to have come into existence in April, 1948, the deed of partnership, which is set out as annexure "A" at page 5 of the paper book, was drawn up only on September 27, 1949. This deed of partnership appears to have

been registered under the provisions of the Indian Partnership Act, on October 12, 1949. It was also forwarded to the Bengal Central Bank, Ltd. Head Office at Calcutta, as it appears from the seal of the bank and the signature dated December 7, 1949. An application to register the firm under section 26A for the assessment year 1949-50, was made to the Income-tax authorities. The firm preferred an appeal to the Income-tax Appellate Tribunal, which was also dismissed by the Tribunal by its order dated September 7, 1953. The ground of the order of the Tribunal was that as the firm admittedly was formed by a verbal agreement in April, 1948, and not by or under an instrument in writing dated September 27, 1949, and as the assessment was for the year 1949-50, for which registration of the firm was sought, the registration could not be ordered. The Tribunal also referred to the letter aforesaid to the Bengal Central Bank, and observed that the letter merely contained information as to the formation of the partnership and of the personnel thereof, but it did not contain the terms on which the partnership had been formed. It also showed that a partnership had been created but not by deed. Hence, the Tribunal further observed, the letter might be useful for consideration on the question of the genuineness of the firm, but it could not fulfill the requirement of section 26A, namely, that the firm should be constituted under an instrument of partnership. Therefore, the Tribunal held that assuming the firm to be genuine, it was not entitled to be registered under section 26A of the Act. Thereupon, the assessee moved the Tribunal under section 66(I) of the Act. That application was granted by the order dated February 2, 1954, and the case stated to the High Court for its decision on the following question :

"Whether the assessee firm which is alleged to have come into existence by a verbal agreement in April, 1948, is entitled to be registered under section 26A for the purposes of assessment for 1949- 50, where the instrument of partnership was drawn up only in September, 1949, after the expiry of the relevant previous year".

The High Court Bench, presided over by Chakravarti, C.J., by its judgment dated August 26, 1955, answered the question in the negative. The learned Chief Justice considered the matter from all possible view points, including grammatical, etymological and textual matters, and came to the conclusion that "constituted" meant "created". He also considered that the preposition "under" is "obviously inappropriate", after having convinced himself that "constituted could be equated with "created". He also could no difficulty in observing that "some of the paragraphs of the Form appear to be ill-adjusted to the provisions of the Act and Rules". In the end, therefore, he conclude with the remarks : "It appears to me to be desirable that the language of the section, as also that of the Rules should receive legislative attention."

In Civil Appeal No. 389 of 1957, Messrs. D. C. Auddy & Brothers, Calcutta, claim to be a partnership consisting of Dulal Chand Auddy, Prem Chand Auddy Gora Chand Auddy and Kalipada Nandy. The partnership business is said to have begun in June, 1944. An application was made on August 24, 1949, for the registration of the partnership. The Income-tax Officer and the Appellate Assistant Commissioner were of the opinion that the partnership was not a genuine one, and could not be registered. Another reason for not ordering registration was that the partnership deed, having been executed on June 2, 1948, could not be operative during the two years under consideration, namely 1945-46 and 1946-47. On appeal, the Income-tax Appellate Tribunal rested its decision on the finding that the alleged partnership had not been constituted under an instrument of partnership within the meaning of those words in section 26A of the Act. At the instance of the assessee, the Tribunal framed the following question for determined by the High Court :

"Whether the assessee firm constituted orally in June, 1944, can validly be registered in the assessment years 1945-46 and 1946-47 under section 26A of the Indian

Income-tax Act on the basis of a memorandum of partnership executed in June, 1948."

The other parts of the statement of the case by the Tribunal refer to the merits of the assessment, with which we are not concerned in this appeal. Hence, it is not necessary to set out those facts. On this part of the statement of the case, the High Court gave the same answer as in the the appeal. In this case also, the High Court granted the necessary certificate under section 66A(2), read with article 135 of the Constitution. As with the cases raise the same question of law, they have been heard together, and will be governed by this judgment.

It is convenient at this stage to set out the relevant provisions of the Act. Section 26A is in these terms :

"26A. Procedure in registration of firms - (I) 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."

The section contemplates the framing of rules laying down the details of the Form in which the application has to be made and the particulars which would be stated in the application, and other cognate matters, Section 59 of the Act, authorizes the Central Board of Revenue, subject to the control of the Central Government to make rules for carrying out the purposes of the Act, and subsection (5) of section 59 provided that rules made under the section, shall be published in the Official Gazette, and "shall thereupon have effect as if enacted in this Act". Income-tax Rules 2 to 6B lay down the details of the procedure for making an application for the registration of a firm as contemplated under section 26A, quoted above. These Rules have been amended extensively in 1952, but we are concerned in this case with the Rules before those amendments. Rule 2 requires such an application to be signed by all the partner personally, and to be made before the income of the firm is assessed for the year under section 23 of the Act. Rule 3 requires that the application be made in the Form annexed to the rule, and that the application "shall be accompanied by the original instrument of partnership under which the firm is constitute..." The Form appearing in rule 3 requires the assessment year to be specified. Thus, the registration is for a particular year of assessment, and not for future years also, and therefore, the application for registration has to be made every year, which in fact means an application for renewal of the registration. Paragraph 3 of the Form requires a certificate to be signed by the applicants for registration, to the effect that the profits (or loss, if any) of the previous year were divided or credited as shown in section B of the Schedule. The form contains the Schedule in 7 columns which require the names of the partners, their addresses, the date of admittance to partnership, their shares in the profits or loss, etc., to be filled in. Under the Schedule, there are section A and section B. Section A has to contain particulars of the firm as constituted at the date of the application, and section B has to contain the particulars of the apportionment of the income, profits or gains(or loss) of the business in the previous year between the partners who in that previous year were entitled to share therein. Rule 4 provides that if the Income-tax Officer is satisfied that there is or was a firm in existence constituted as shown in the

instrument of partnership, and that the application has been properly made, he has to enter a certificate at the foot of the instrument of partnership that the firm has been registered under section 26A of the Act and that the certificate of registration shall have effect for the assessment for the year specified therein. Rule 5 is as follows :

"5. The certificate of registration granted under rule 4 shall have effect only for the assessment to be made for the year mentioned therein."

And rule 6 makes provision for the certificate of registration to be renewed for a subsequent year, on an application being made in that behalf in accordance with the preceding rules.

It is manifest that for a true and proper construction of the relevant provisions of the Act, relating to registration of firms, section 26, 26A and 28, and the rules summarized above have to be read together, So read, it is reasonably clear that the following essential conditions must be fulfilled in order that a firm may be held entitled to registration :

- (1) That the firm should be constituted under an instrument of partnership specifying the individual shares of the partners.
- (2) That an application on behalf of, and signed by, all the partners, containing all the particulars as set out in the Rules, has been made;
- (3) That the application has been made before the assessment of the income of the firm, made under section 23 of the Act (omitting the words not necessary for out present purpose) for that particular year;
- (4) That the profits (or loss, if any) of the business relating to the previous year, that is to say, the relevant accounting year, should have been dividend or credited, as the case may be, in accordance with the terms of the instrument; and lastly,
- (5) That the partnership must have been genuine and must actually have existed in conformity with the terms and conditions of the instrument.

It is clear from what has been said above with reference to the relevant provisions of the Act, that the certificate of registration has reference to a particular assessment year, and has effect for the assessment to be made for that particular year. In other words, the terms of the partnership should appear in instrument of partnership in respect of the relevant accounting year. It is equally clear that the firm to be registered should have been in existence during the accounting year, "constituted as shown in the instrument of partnership". The Rules, thus, contemplate a document operative during the accounting year. We are not here concerned with the further question whether the document should be in existence at the very inception of the accounting year, or before the year is out.

The provision of the Act, set out above, do not present any serious difficulty except for the words "constituted under an instrument of partnership" occurring in section 26A and the relevant Rules. On the interpretation of these words, there has been a conflict of judicial opinion, as will presently appear. On behalf of the assessee- appellants, it has been contended that so long as the assessment has not been a made, the assessee are entitled to have their for, s registered in accordance with the terms of the instrument of partnership, irrespective of the year in which the instrument may have come into existence. Strong reliance was placed upon the decision of the Bombay High Court (Chagla, C.J., and Tendolkar, J.) in the case of Dwarkadaas Khetan & Co. v. Commissioner of

Income-tax wherein, the following observations have been made :

"Any firm can make an application under section 26A for registration and the two conditions that it has got to comply with are that it must be constituted under an instrument of partnership and the second condition is that the instrument of partnership must specify the individual shares of the partners. If these two conditions are satisfied it would be entitled to registration. The section does not require that the firm must come into existence by reason of the instrument of partnership, or that the firm must not exist prior to the instrument of partnership being executed."

In the case decided by the Bombay High Court, the instrument of partnership had been executed on March 27, 1946, with effect from January 1, 1946. On an application made to the Department to register the firm, the matter was determined by the Income-tax Appellate Tribunal against the assessee on the ground that the partnership was in existence before the deed was executed, and that, therefore, it could not be registered. Before the Bombay High Court, reliance had been placed on behalf of the Department on the decision of the Calcutta High Court, now before us in appeal, as also on a decision of the Punjab High Court. The decision of the Calcutta High Court now under examination, in the case of R. C. Mitter and Sons v. Commissioner of Income-tax takes the view that section 26A of the Act contemplated a firm created or brought into existence by an instrument of partnership, which governs the distribution of shares in the relevant accounting period. Such a deed should have come into existence on or before the commencement of the relevant accounting period. The other decision relied upon in the Bombay High Court has been given by a Division Bench of the Punjab High Court, reported in Padam Parshad Rattan Chand v. Commissioner of Income-tax, Delhi.

On the other hand, it has been contended on behalf of the Revenue that in order to entitle a firm to be registered, the firm should have been created by an instrument of partnership, or, at any rate, such an instrument should be in existence during the relevant accounting year, that is, the year previous to the year of assessment in respect of which the application for registration has been made. For the first part of the submission on behalf of the respondent, there is ample authority in the decision under appeal which had been relied upon before the Bombay High Court. In that case, (R. C. Mitter & Sons v. Commissioner of Income-tax) Chakravarti, C.J. Who delivered the opinion of the court under section 66(1) of the Act, after a very elaborate discussion, came to the conclusion which may best be expressed in his own words, as follows :

"If by the expression 'constituted under an instrument of partnership' is meant a firm which originated in a verbal agreement but with respect to which a formal deed was subsequently executed, there would be no room in the section for partnerships, actually created by an instrument and such partnerships, although most obviously entitled to registration, would be excluded from the purview of the section. Even etymologically or textually, I do not think that the word 'constituted', when used in relation to a firm or such other body, can mean anything but 'created' when the reference is to some deed or instrument to which the inception of the firm or other body is to be traced."

After having, thus, held that section 26A contemplated firms created or brought into existence by a deed in writing, he had no difficulty in substituting "by" for "under", thus, making the crucial words "constituted by" instead of "constituted under". In our opinion, the learned Chief Justice fell into the error of re-constructing the provision of the statute, instead of construing them. The word, "by"

could be substituted for the word "under" in section 26A only if the words as they stand in the section, were not capable of making sense, and it would, thus, have been necessary to amend the wording of the section. Turning his attention from the wording of the section to that of the Rules and the Form appearing under that Rules, he again came to the conclusion that "Some of the paragraph of the Form appear to be ill-adjusted to the provisions of the Act". Referring to other parts of the Rules, he was contained to observe that they "would lend strong support to the view that what is meant by 'any firm constituted under an instrument of partnership, in section 26A is no more than a firm of which the constitution appears from an instrument in writing. It is obvious that if such be the meaning of the expression constituted under an instrument of partnership', the instrument need not be one by which the partnership was created". But then he attempted to get over that difficulty by observing that the language of the Rules and the Form could not supersede a provision contained in the Act itself. He further opined that the language in paragraph 4(1) is "undoubtedly unsatisfactory". In our opinion, any attempt to reconstruct the provisions of the relevant section and the Rules, on the assumption that the intention of the Legislature was to limit the registration of firms to only those which have been created by an instrument of partnership, is, with all respect, erroneous. The proper way to construe the provisions of the statute is to give full effect to all the words of the relevant provision, to try them harmoniously, and then to give them a sensible meaning. Hence we have to consider, at the threshold, the question whether the words "constituted under an instrument of partnership" have some meaning which can be attributed to them harmoniously with the rest of the relevant provisions. A partnership may be created or set up by a contract in writing, setting out all the terms and conditions of the partnership, but there may be many cases, and perhaps, such cases are more numerous than the other class where a partnership has been brought into existence by an oral agreement between the parties on certain terms and conditions which may subsequently be reduced to writing which will answer the description of an instrument of partnership. Such an instrument would, naturally, record all the terms and conditions of the contract between the parties which, at the initial stages, had not been reduced to writing. In such a case, though the partnership had been brought into existence by an oral agreement amongst the partners, if the terms and conditions of the partnership have been reduced to the form of a document, it would be right to say that the partnership has been constituted under that instrument. The word "constituted" does not necessarily mean "created" or "set up", though it may mean that also. It also includes the idea of clothing the agreement in a legal form. In the Oxford English Dictionary, Vol. II, at page 875 and 876, the word "constitute" is said to mean, inter alia, "to set up. establish, found (an institution, etc.)" and also "to give legal or official form or shape to (an assembly, etc.)" Thus, the word in this wider significance would include both the idea of creating or establishing and the idea of giving a legal form to, a partnership. The Bench of the Calcutta High Court in the case of R. C. Mitter & Sons v. Commissioner of Income-tax under examination now, was not, therefore, right in restricting the word "constitute" to mean only "to create", when clearly it could also mean putting a thing in a legal shape. The Bombay High Court, therefore, in the case of Dwarkadas Khetan & Co. v. Commissioner of Income-tax, was right in holding that the section could not be restricted in its application only to a firm which had been created by an instrument of partnership, and that it could reasonably and in conformity with commercial practice, be held to apply to a firm which may have come into existence earlier by an oral agreement, but the terms and conditions of the partnership have subsequently been reduced to the form of a document. If we construe the word "constitute" in the larger sense, as indicated above, the difficulty in which the learned Chief Justice of the Calcutta High Court found himself would be obviated in as much as the section would take in cases both of firms coming into existence by virtue of written documents as also those which may have initially come into existence by oral agreements but which had subsequently been constituted under written deed. The purpose of the provision of the Income-tax

Act - section 26A - is not to compel the firms which had been brought into existence by oral agreements to dissolve themselves and to go through the formality of constituting themselves by instruments of partnership. If we construe the words "constituted under" in that wider sense, we give effect to the intention of the Legislature of compelling a firm which had existed as a result of an oral agreement to enter into a document defining the terms and conditions of the partnership, so as to bind the partners to those terms, before they could get the benefit of the provisions of section 23(5)(a) confers a privilege upon partners who may find it more worth their while to be assessed upon their individual total income than upon the total income of the partnership. It is, therefore, very important from the point of view of the Revenue that the Department should be apprised in time of the true constitution of the partnership, the names of the true partners and the precise shares of each of them in the partnership profits (or loss, if any). The very object of this provision will be defeated if the alleged partnership is not genuine, or if the true constitution of the partnership and the respective shares of the partner are not fully and correctly placed on record as soon as possible, for the purpose of assessment. In this connection, the provisions of section 28(2) of the Act are also worth noticing. That sub-section provides that if the Income-tax Officer or the appellate authorities under the Act are satisfied that the profits of a registered firm have been distributed otherwise than in accordance with the shares of the partners, as shown in the instrument of partnership registered under the Act, and governing such distribution, and that any partner has concealed any part of his profits, the penalty prescribed therein may be imposed upon such a partner. Unless the instrument of partnership has been registered in respect of the accounting year and before the assessment has been done, the penal provisions aforesaid cannot be enforced. It is, therefore, essential, in the interest of proper administration and enforcement of the relevant provisions relating to the registration of firms, that the firms should strictly comply with the requirement of the law, and it is incumbent upon the Income-tax authorities to insist upon full compliance with the requirement of the law. But, in our opinion, there is no warrant in the words of the relevant provision of the statute for restricting registration under section 26A of the Act to those firms only which have been created or brought into existence by an instrument of partnership. In our opinion, it is more in consonance with the terms of the relevant provisions of the Act, referred to above, to hold that the words "constituted under an instrument of partnership" include not only firms which have been created by an instrument of partnership but also those which may have been created by word of mouth but have been subsequently clothed in legal form by reducing the terms and conditions of the partnership to writing.

We have already indicated that there has been a conflict of judicial opinion in the different High Court in India on the question now before us. But on a consideration of the facts in each case, it will be found that the decision arrived at in most of the case was correct, though the reasons given appear to have gone beyond the requirement of the case. The decision of the Bombay High Court in *Dwarkadas Khetan & Co. v. Commissioner of Income-tax* discloses that the partnership then in question had come into existence with effect from the beginning of 1946, though the instrument of partnership was executed on March 27, 1946. Thus, the instrument of partnership came into existence during the accounting year, whatever that year may have been, because the year 1946 was the starting year of the partnership. Hence, even the earliest assessment year, presumably the year 1947-48, would be governed by the terms and conditions of the written instrument of partnership aforesaid. The decision of the Bombay High Court was followed by the same Bench of that court in the case of *Commissioner of Income-tax v. Shantilal Vrajlal & Chandulal Dayalal & Co.* In the second case, the learned Judges ruled that the second partnership deed of September 12, 1951, which set out the names and shares of all the partners who constituted the partnership, could be registered in respect of the accounting year November, 1948, to October, 1949. This conclusion was

arrived at without even a mention, far less a discussion, of the relevant provisions of the Act. Apparently the matter was not critically placed before the learned Judges, when they decided the second case. The conclusion in this case is, with all respect, apparently wrong in view of our conclusion that the instrument of partnership should have been in existence in the accounting year.

In the High Court of Punjab, the question was fully discussed in a judgment of a Division Bench, given by one of us (Kapur, J., as he then was), in the case of *Kalsi Mechanical Works v. Commissioner of Income-tax*. In that case, the firm had come into existence by a verbal agreement in June 1944. The deed of partnership was drawn up as late as May 9, 1949. The application for registration of the firm under section 26A for the assessment year 1949-50, was dismissed by the Income-tax authorities as also by the Tribunal. The High Court, after an elaborate examination of the relevant provision of the Act, including the Rules and the Forms, upheld the orders of the Department. The conclusion of the Bench was in these terms :

"The section of the Income-tax Act show that for the purpose of registration it is necessary that the firm should be constituted by an instrument of partnership and in my opinion the rules read with sections 26 and 28 of the Act indicate that such a firm as is constituted under an instrument of partnership should have been in existence during the account period and should not come into existence during the assessment year, and if it was not in existence during the account period it cannot be registered so as to affect their liabilities of the partners for income-tax occurring during the account period".

The conclusion reached is correct, except with all respect, for the observation that under section 26A, it is necessary that the firm should be constituted "by" an instrument of partnership. That is the leading judgment in the High Court of Punjab. It was followed by another Division Bench of that court in the case of *Padam Parshad Rattan Chand v. Commissioner of Income-tax* to the effect that "constituted under an instrument" in section 26A meant, "created or formed by a formal deed". In this case, the business of the firm had started from April 1, 1947, but the instrument of partnership was executed on April 10, 1950. The application for registration was made in respect of the assessment year 1948-49. It is clear with reference to these dates that the instrument of partnership was not in existence either during the accounting year or even during the assessment year, and the court, therefore, rightly held that the partnership could not be registered in respect of the assessment year; but they proceeded further to observe that there was no objection to the firm being treated as having been constituted under the instrument as from the date of the instrument itself. The answer of the court to the question posed was that the firm could be registered not in respect of the assessment year for which the application had been made, but with effect from the date of the instrument. Apparently, the attention of the court was not drawn to the rules aforesaid, particularly, rules 2 and 3, which require that the application has to be made before the assessment is completed and for a particular assessment year. More or less to the same effect are two other Division Bench rulings of that High Court in *Bery Engineering Co. v. Commissioner of Income-tax Delhi*. and *Income-tax Commissioner v. Messrs. Birdhi Chand Girdhari Lal*. In all these cases in the Punjab High Court, the deeds came into existence later than the accounting year or the assessment year, and, therefore, could not have been registered. The actual decisions in these cases were correct, though there are obiter dicta to the effect that section 26A requires that the firm should have been created or set up by an instrument of partnership.

In the Patna High Court, the very same question was discussed at great length by a Division Bench of that court, presided over by Ramaswami, C.J., in the case of *Khimji Walji & Co. v.*

Commissioner of Income-tax. The learned Chief Justice, after an elaborate examination of the relevant provisions of the Act, came to the conclusion in these terms :

"It is necessary for the purpose of registration under section 26A that the partnership should be constituted by an instrument of partnership and that such a partnership as is constituted under an instrument of partnership should have been in existence during the accounting year."

It is on the same lines as the leading judgment of the Punjab High Court. With reference to the dates given in the judgment, the decision is right, though in this case also, the words "constituted under" have been construed as "constituted by", without discussing the necessity for so amending the words of the statute, even as in the Punjab High Court decisions.

As a result of the above discussion, the conclusion is reasonably clear that unless the partnership business was carried on in accordance with the terms of an instrument of partnership which was operative during the accounting year, it cannot be registered in respect of the following assessment year. As in these cases, the partnership did not admittedly function under such a deed of partnership, the Department and the High Court were right in refusing registration. We would, therefore, dismiss these appeals but for different reasons to those given below. The respondent is entitled to his costs - one set of hearing fees to be paid half and half by the appellants.

HIDAYATULLAH, J. -

I have had the advantage of reading the judgment just delivered by my brother, Sinha, J. I agree that section 26A of the Indian Income-tax Act must be read as it is. The words of the section, as they stand, are not meaningless, and in view of the decision in *Commissioners for special Purposes of the Income-tax v. Pemsell* it is not possible to read for the expression "constituted under", the words "constituted by".

I entertain, however, some doubt as to whether the instrument sought to be registered should be in existence in the accounting year, before registration can be claimed. There is nothing in the Act which says this specifically. My brother has rewound from the contents of the Act and the Rules that such a condition is implied. While I entertain some doubts, I am not prepared to record a dissent, more so as the Board of Revenue has issued instructions that all firms should be registered, whether the documents under which they were constituted existed in the accounting year or not, provided the Income-tax Officer was satisfied about the genuineness of the firms.

In the result, I agree that the appeals should be dismissed with costs.

Appeals dismissed.

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