

Commissioner of Income-Tax, Madras

Vs

Sivakasi Match Exporting Co

Civil Appeal No. 700 of 1963

(K. Subba Rao, J. C. Shah, S. M. Sikri JJ)

29.04.1964

JUDGMENT

SUBBA RAO J. -

This appeal by special leave is directed against the order of the High Court of Madras in a reference made to it by the Income-tax Appellate Tribunal under section 66(2) of the Indian Income-tax Act, 1922, hereinafter called the Act.

The facts that have given rise to the appeal may briefly be stated. There are 5 firms in Sivakasi manufacturing matches under the name and style of Shenbagam Match Works, Brilliant Match Works, Manoranjitha Match Works, Pioneer Match Works and Gnanam Match Works. The total number of the partners of all the 5 firms does not exceed 10 or 11 in number. Rajamoney Nadar is the sole proprietor of Shenbagam Match Works and in the other 4 firms there are more than one partner. In the year 1948 a person from each of those firms in his representative capacity formed a partnership to carry on the business of banking and commission agents, the principal business being the marketing of the products of the different match factories in Sivakasi. When the said partnership applied for registration for the assessment year 1949-50, it was refused by the income-tax department on the ground that different firms could not constitute a valid partnership. Thereafter, Sankaralinga Nadar, Arumughaswami Nadar, Arunachala Nadar, Palani

Learned counsel for the revenue raises before us the following two points, namely, (i) the finding of the Appellate Tribunal was one of fact and that the High Court had no jurisdiction to canvass the correctness of its finding on a reference made under section 66(2) of the Act, and (ii) the conclusion arrived at by the Tribunal was the correct one and the High Court erroneously with it.

It is commonplace that under section 66(2) of the Act a reference to the High Court lies only on a question of law. The scope of the provision has been elaborately considered by this court in Sree Meenakshi Mills Ltd. v. Commissioner of Income-tax. Therein the scope of the provision has been laid down under different propositions. On the basis of the judgment it cannot be gainsaid that if the order refusing registration goes beyond the scope of the jurisdiction conferred on the Income-tax Officer under section 26A of the Act and the rules made thereunder or if the decision depends upon the construction of the partnership deed or if there is no evidence to sustain the finding of the Tribunal, then the High Court will have jurisdiction to entertain the reference under section 66(2) of the Act.

In our view, the finding of the Tribunal falls squarely under the said three heads. The relevant provisions of the Act read thus :

"26A. (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."

In exercise of the powers conferred by section 59 of the Act, the Central Board of Revenue made the following rules :

"2. 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 (hereinafter in these rules referred to as the Act), register with the Income-tax Officer, the particulars contained in the said instrument on application made in this behalf.

Such application shall be signed by all the partners (not being minors) personally and shall be made -

(a) before the income of the firm is assessed for any year under section 23 of the Act, or. . ."

'3. The application referred to in rule 2 shall be made in the form annexed to this rule and shall be accompanied by the original instrument of partnership under which the firm is constituted, together which a copy thereof :"

"FORM 1

Form of application for Registration of a Firm under section 26A of the Indian Income-tax Act, 1922. . ."

"4. If, on receipt of the application referred to in rule 3, 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 shall enter in writing at the foot of the instrument or certified copy, as the may be, a certificate in the following form, namely :- . . ."

"6B. In the event of the Income-tax Officer being satisfied that the certificate granted under. . . rule 6A, has been obtained without there being a genuine firm in existence, he may cancel the certificate so granted."

A combined effect of section 26A of the Act and the rules made thereunder is that if the application made by a firm gives the necessary particulars prescribed by the rules, the Income-tax Officer cannot reject it, if there is a firm in existence as shown in the instrument of partnership. A firm may be said to be not in existence if it is a bogus or not a genuine one, or if in law the constitution of the partnership is void. The jurisdiction of the Income-tax Officer is, therefore, confined to the ascertaining of two facts, namely, (i) whether the application for registration is in conformity with

the rules made under the Act, and (ii) whether the firm shown in the document presented for registration is a bogus one or has no legal existence. Further, the discretion conferred on him under section 26A is a judicial one and he cannot refuse to register a firm on mere speculation, but he shall base his conclusion on relevant evidence.

What are the facts in the present case ? The partnership deed is dated April 1, 1950. In the document five persons are shown as its partners. The name of the firm is given, the objects of the partnership business are described, the duration of the business is prescribed and the capital fixed is divided between them in equal shares. Clause 16 of the partnership deed, on which the Tribunal relied, reads :

"This firm shall collect a commissioner of half an anna per gross on the entire production of the match factories of the partners, respectively, the Brilliant Match Works, Manoranjitha Match Works, Pioneer Match Works, Shenbagam Match Works and Gnanam Match Works, produced from 1st April, 1950, whether sales were effected through this firm or not and a further commission will be collected on all kinds of matches produced from the abovesaid factories. The commission of half an anna per gross on the entire production of these factories accrued due at the end of every months shall be debited to the respective factories under advice to them."

Clauses 22 and 23 which throw further light on the question raised read :

"22. The business of this firm shall have and has no connection with the match manufacturing business carried on now by the partners separately or in partnership with others.

23. Any loss to the firm by way of fire, accident or by any other cause during the course of the business of the firm, notwithstanding the fact that the loss might have arisen on the sale of or transaction relating to the match manufacturing concerns of the partners to this deed, shall be borne by this firm and shall be equally divided between the partners to this deed."

It is not disputed that the partnership deed ex facie conforms to the requirements of the law of partnership as well as the Income-tax Act. Under section 4 of the Indian Partnership Act, partnership is the relation between persons who have agreed to share the profits of the business carried on by all or any of them acting for all; persons who have entered into the partnership with one another are called individually partners and collectively a firm and the name under which the business is carried on is called the firm name. The document certainly conforms to the said definition. There is also no prohibition under the Partnership Act against a partner or partners of other firms combining together to form a separate partnership to carry on a different business. The fact that such a partner or partners entered into a sub-partnership with others in respect of their share does not detract from the validity of the partnership; nor the manner in which the said partner deals with the share of his profits is of any r

But the Tribunal has held that the partnership is not a genuine one for the following reasons : (i) previously the firm entered into a partnership but the registration of the same was rejected; (ii) under clause 16 of the partnership deed the firms have the right to collect the commission of the entire match production of the larger partnerships whether they effect their sales through the firm or not; (iii) the books of Gnanam Match Works show unmistakably that the capital was contributed not

by Palaniswamy Nadar in his individual capacity but by the larger firm as such; and (iv) regarding the other three larger firms also the profit derived by their representatives from the assessee firm was divided amongst all the partners according to their profit sharing ratio in the larger firms. On the other hand, the High Court found, on a construction of the relevant clauses of the partnership deed that the two circumstances relied upon by the Tribunal were irrelevant in ascertaining whether the said partnership was

The Tribunal mixed up the two concepts, viz., the legality of the partnership and the ultimate destination of the partners' profits. It also mixed up the question of the validity of the partnership and the object of the individual partners in entering into the partnership. If to avoid a legal difficulty 5 individuals, though four of them are members of different firms, enter into a partnership expressly to comply with a provision of law, we do not see any question of fraud or genuineness of law. It is a genuine document and it complies with the requirements of law. It is not an attempt to evade tax, but a legal device to reduce its tax liability. The fact that all the partners of all the firms did not exceed 12 in number and if they chose all of them could have entered into the partnership indicated that there was no sinister motive behind the partnership. As the Tribunal misconstrued the provisions of the partnership deed and relied upon irrelevant considerations in coming to the conclusion it did, the High

In the result, the appeal is dismissed with costs.

SHAH J. ♦

Sivakasi Match Export Company - hereinafter referred to as "the assessee" - is a partnership "carrying on business as bankers, commission agents and distributors of the products of different match factories at Sivakasi in the State of Madras." The assessee firm was formed under a deed dated April 1, 1950. There were five partners of the firm (1) N. P. A.M. Sankaralinga Nadar (2) K. S. S. Arumughaswami Nadar (3) K. A. S. Arunachala Nadar (4) K. P. A. T. Rajamoney Nadar and (5) V. S. V. P. Palaniswamy Nadar. Before April 1, 1950, there existed a firm also named Sivakasi Matches Exporting Company which "consisted of a combine of six match factories" at Sivakasi constituted under a partnership deed dated March 12, 1948. Registration of this partnership under section 26A of the Income-tax Act, 1922, was refused on the ground that the partnership deed did not specify the actual shares of the individual partners. Thereafter, a deed forming the partnership which is sought to be registered in these proceedings on April 1, 1950. It was recited in the preamble that originally four out of the five partners had been carrying on business in partnership as representatives of their respective match concerns, and it was found necessary that they should carry on the said business from April 1, 1950, jointly in their individual capacity, and it was agreed to admit into their partnership as and from April 1, 1950, the fifth person, namely, V. S. V. P. Palaniswamy Nadar. The following are the material paragraphs of the agreements of partnership :

"(16) This firm shall collect a commission of half an anna per gross on the entire production of the match factories of the partners, respectively, The Brilliant Match Works, Manoranjitha Match Works, Pioneer Match Works, Shenbagam Match Works and Gnanam Match Works, produced from 1st April, 1950, whether sales were effected through this firm or not and a further commission of half an anna per gross on the sales effected through this firm. This commission will be collected on all kinds of matches produced from the abovesaid factories. The commission of half an anna per gross on the entire production of these factories accrued due at the end of every month shall be debited to the respective factories under advice to them.

(22) The business of this firm shall have and has no connection with the match manufacturing business carried on now by the partners separately or in partnership with others.

(23) Any loss to the firm by way of fire, accident or by any other cause during the course of the business of the firm, notwithstanding the fact that the loss might have arisen on the sale of or transaction relating to the match manufacturing concerns of the partners to this deed, shall be borne by this firm and shall be equally divided between the partners to this deed."

It is common ground that each partner was concerned in the manufacture of matches either as owner or as partner with others. Sankarahnga Nadar carried on business as a manufacturer of matches with two others in the name of the Brilliant Match Works, Arumughaswamy Nadar as a partner with three others in the name of the Manoranjitha Match Works, Arunachala Nadar as a partner with two others in the name of the Pioneer Match Works, Rajamoney Nadar as a sole proprietor of the Shenbagam Match Works, and Palaniswamy Nadar as a partner with three others in the name of the Gnanam Match Works.

On October 27, 1952, the Income-tax Officer passed an order under section 26A granting registration of the partnership constituted under the deed dated April 1, 1950, but the Commissioner of Income-tax, Madras, exercising revisional jurisdiction under section 33B of the Act, set aside the order and directed that the partnership be assessed to tax as an unregistered firm. In the view of the Commissioner the partnership deed did not represent the true state of affairs and the "the actual position as distinguished from the recitals in the partnership deed was that all the partners of the match factories were directly partners of the assessee" and as the names relating to registration had not been complied with, registration be refused. The order was confirmed in appeal to the Income-tax Appellate Tribunal.

At the direction of the High Court of Madras under section 66(2) of the Indian Income-tax Act, 1922, the Tribunal referred the following question :

"Whether on the facts and in the circumstances of the case the refusal of registration of the assessee firm under section 26A of the Income- tax Act was correct in law ?"

The High Court answered this question in the negative. Against that order, with special leave, the Commissioner of Income-tax had appealed to this court.

The Tribunal held that the covenant in the deed of partnership and specially in paragraphs 3 and 16 viewed in the light of the entry in the books of account of Gnanam Match Works debiting the capital contributed in the name of Palaniswamy Nadar to the assessee, and not in the name of its partner, and division of the profits received from the assessee by Palaniswamy Nadar, Sankaralinga Nadar, Arumughaswamy Nadar and Arunachalam Nadar with other owners of their respective business, indicated that the named partners were acting as representatives of those owners. The High Court also held that clause 16 of the partnership agreement did not impose any liability upon the manufacturing concerns to pay any commission as stipulated therein on the production of the match factories. The High Court observed :

"Clause 10 does not lay any liability upon the manufacturing concerns and cannot operate as an enforceable contract against those other match companies. If one of

those match companies should decline to put through its sales business through the assessee firm, the only result would perhaps be that the partnership would not advance moneys or finance to that manufacturing concern; it might also be that the particular partner interested in the manufacturing concern might stand to lose the benefit of this partnership. But that is not the same thing as to say that those manufacturing concerns themselves had become partners of the assessee partnership."

The High Court also observed that the assessee was not concerned with the disposal of the profits received by its partners. Finally, the High Court observed that "an individual member of the partnership is not prevented from engaging in business as member of another partnership. The law does not prohibit such a course and even the income-tax law relating to registration of partnerships only refuses registration when the formation of such partnerships is intended to evade the incidence of income-tax and nothing more. We are not satisfied that the Tribunal correctly appreciated works were the real parties to this instrument of partnership.

The Solicitor - General for the Commissioner contended that the High Court had in exercising its advisory jurisdiction, in substance assumed appellate powers and had sought to reappraise the evidence on which the conclusion of the tribunal was founded. Counsel contended that the tribunal had recorded a clear finding on the facts that the "match works were the real" partners, and the High Court was bound on the question framed to record its opinion on the question of law referred on the basis of that finding.

Section 26A of the Indian Income-tax Act enacts the procedure for registration of firms. By that section on behalf of any firm application may be submitted to the Income-tax Officer for registration, if the firm is constituted under an instrument of partnership, specifying the individual shares of the partners. The application has to be made by such person or persons and at such times and shall contain such particulars and shall be in such form as may be prescribed. It is open to a firm to carry on business without registration under the Indian Registration Act. By obtaining an order of registration, the partners of the firm are enabled to get the benefit of lower rates of tax than those applicable to the whole income of the firm, when charged as a unit of assessment. In the relevant year of assessment if the firm was unregistered the tax payable by it had to be determined as in the case of any other distinct entity and tax had to be levied on the firm itself. If, however, the firm was registered, the firm d

On the conclusion recorded by the Tribunal that the partnership deed dated April 1, 1950, was in truth an instrument relating to an agreement to carry on business by all the persons who owned the five businesses of which the representatives signed the deed, the application submitted by the five named partners of the assessee did not conform to the requirements of rules 2 and 3 and the Income-tax Officer was bound to refuse registration. It is true that the ground given by the Tribunal that the share of profits received by individual partners of the assessee was distributed by four of those partners who had entered into partnership contracts with other persons in the business of their respective match factories, standing independently of other grounds, may not be of much value in deciding whether all the partners of the match factories were intended to be partners of the assessee. It is open to a partner who receives his share in the profits of the firm to dispose of that share in any manner he pleases, and n

It was not the case of the assessee that there was no evidence on which the conclusion arrived at by the Tribunal could be founded, nor was it the case of the assessee that the conclusion was so

perverse that no reasonable body of men properly instructed in the law could have arrived at the conclusion. It is also clear from the record that no such question was even canvassed before the Tribunal. Manifestly such a question could not arise out of the order of the Tribunal, and none such was referred to the High Court. By the question actually referred, the tribunal sought the opinion of the High Court whether on the facts and circumstances refusal of the application for registration of the assessee was correct in law. If it was the case of the assessee that the conclusion of the Tribunal was based on no evidence, or that it was perverse, the High Court could be asked to call for a reference from the Tribunal on that question. But that was never done.

It is true that the object of enacting section 26A and the rules relating to the procedure for registration is to prevent escapement of liability to tax. But it is not necessary that before an order refusing registration is made, it always open to a person, consistently with the law, to so arrange his affairs that he may reduce his tax liability to the minimum permissible under the law. The fact that the liability to tax may be reduced by the adoption of an expedient which the law permits, is wholly irrelevant in considering the validity of that expedient. But where the law prescribes conditions for obtaining the benefit of reduced liability to taxation, those conditions, unless otherwise provided, must be strictly complied with, and if they are not so complied with the taxing authorities would be bound to refuse to give the taxpayer the benefit claimed. When application for registration of the firm is made, the Income-tax Officer is entitled to ascertain whether the names of the partners in the instrument a come-tax Officer may be justified in refusing registration.

In my view the High Court was in error in holding on the question submitted that the registration of the assessee under section 26A of the Income-tax Act was wrongly refused.

The answer to the question referred to the High Court should be in the affirmative.

ORDER. - In accordance with the opinion of the majority, the appeal is dismissed with costs.

Appeal dismissed.

</html