

Third Income Tax Officer, Circle-I, Salem and Another

Vs

Arunagiri Chettiar

Civil Appeals Nos. 1615-16 of 1977

(B. P. Jeevan Reddy, S. C. Sen JJ)

07.05.1996

JUDGEMENT

B. P. JEEVAN REDDY, J.:-

1. The question in these appeal is, whether an erstwhile partner is liable to pay the tax arrears due from the partnership firm pertaining to the period when he was a partner. The Madras High Court has held that he is not. The Revenue is disputing the correctness of that holding.

2. The respondent-assessee was a partner in the firm, Sannanna Chettiar and Sons. He retired therefore on April 19, 1963. On his retirement, the firm was continued by taking in two new partners. The said firm too was dissolved with effect from April 12, 1972. The assessment for the Assessment Years 1962-63 and 1963-64 were completed on March 25, 1967 and March 29, 1968. (For the two accounting years relevant to the said assessment years accounts were duly made up by the partners and the share of profits due to the respondent paid to him before his retirement.) On February 23, 1972, the Income Tax Officer sent a communication to the respondent that in respect of the arrears of tax due from the firm for the aforesaid assessment years, he too is jointly and severally liable along with the other partners inasmuch as he has a partner of the firm during the relevant accounting years. The respondent denied his liability on the ground that he ceased to be a partner long ago, that there was a change in the constitution of the firm after his retirement and that such re-constituted partnership alone is responsible for paying the said arrears. The Income Tax Officer did not agree with the respondent's contentions. Recovery proceedings were initiated and the respondent's properties attached, whereupon he approached the Madras High Court by way of two writ petitions. The High Court allowed the writ petitions mainly relying upon and following the decision of a Full Bench of the Kerala High Court in Income Tax Officer, Assessment II, Calicut v. C.V. George, (1976) 105 ITR 144 : (1976 Tax LR 938) which dissented from the decision of the Allahabad High Court in Sahu Rajeshwar Nath v. Income Tax Officer, Meerut, (1964) 54 ITR 755. The reasoning of the High Court, in short, is this : Section 189 (3) has no application to the facts of the case inasmuch as the respondent was not a partner of the firm at the time of its dissolution; he ceased to be a partner long prior to the dissolution. Further, because the Income-tax Act, 1961 did not contain a provision corresponding to the proviso to sub-section (2) of Section 46 of the Indian Income-tax Act, 1922, the arrears of tax due from the firm cannot be recovered from an erstwhile partner.

3. Sri. B. B. Ahuja, learned counsel for the appellant-Revenue, assailed the correctness of the judgment under appeal and also that of the Full Bench decision of the Kerala High Court aforesaid.

Learned Counsel pointed out that the decision of the Allahabad High Court in Sahu Rajeshwar Nath, (1964) 54 ITR 755 (which was dissented from by the Full Bench of the Kerala High Court) has actually been affirmed by this Court in Sahu Rajeshwar Nath v. Income Tax Officer, C-Ward, Meerut, (1969) 72 ITR 617 : (AIR 1969 SC 667) and that the reasoning and approach of the Allahabad High Court and of this Court is clearly at variance with the reasoning of the judgment under appeal. Since the respondent assessee was unrepresented, we requested Mrs. Ramachandran to assist us in this matter, to which she has agreed gracefully. We are grateful for her valuable assistance. Learned counsel supported the reasoning and conclusion of the Madras and Kerala High Courts. Learned counsel submitted that the decision of this Court in Sahu Rajeshwar Nath does not in any manner affect the correctness of the reasoning contained in judgment under appeal.

3A. Clause (23) of Section 2 of the Income Tax Act, 1961 (1961 Act) says that "'firm', 'partner' and 'partnership' have the meanings respectively assigned to them in the Indian Partnership Act, 1932; but the expression 'partner' shall also include any person who, being a minor, has been admitted to the benefit of partnership". (Since we are concerned with the position obtaining prior to April 1, 1989 (i.e. prior to the introduction of Section 188-A by the Direct Tax Laws (Amendment) Act, 1989) we shall refer to the relevant provisions as they stood prior to April 1, 1989). Chapter XVI contains special provisions applicable to firms. Section 182 provides for assessment of registered firms while Section 183 provides for assessment of un-registered firms. Section 184 provides for application for registration and Section 185 prescribes the procedure to be followed on receipt of such application. Section 186 deals with cancellation of registration. Section 187 to 189 deal with changes in the constitution of the firm, succession of one firm by another and with the dissolution of the firm. Sub-section (10) of Section 187 provides that "where at the time of making an assessment under Section 143 or Section 144, it is found that a change has occurred in the constitution of a firm, the assessment shall be made on the firm as constituted at the time making the assessment". Sub-section (2) of Section 187 specifies what does the expression "change in the constitution of the firm" mean in the said section.

4. Section 156 provides for issuance of a notice of demand upon the assessee specifying the sum payable. If the tax is not paid pursuant to the notice of demand, it has to be recovered in accordance with the Rules contained in the second Schedule to the Act.

5. In the Indian Income-Tax Act, 1922 (1922 Act), Section 46 provided that the arrears of income tax shall be recovered as arrears of land revenue by the Collector. The proviso to sub-section (2) provided that "without prejudice to any other powers of the Collector in this behalf, he shall for the purpose of recovering the said amount, have the powers which under the Code of Civil Procedure, 1908 (V of 1908), a Civil Court has for the purpose of the recovery of an amount due under a decree.....". Sub-Rules (1) and (2) of Rule 50 of Order 21 of the Code of Civil Procedure prescribe the mode of execution of a decree obtained against a firm. Rule 50 reads :

"50. Execution of decree against firm - (1) Where a decree has been passed against a firm, execution may be granted -

(a) against any property of the partnership;

(b) against any person who has appeared in his own name under Rule 6 or Rule 7 of Order XXX or who has admitted on the pleadings that he is, or who has been adjudged to be, a partner;

(c) against any person who has been individually served as a partner with a summons and has failed to appear;

Provided that nothing in this sub-rule shall be deemed to limit or otherwise affect the provisions of Section 30 of the Indian Partnership Act, 1932 (9 of 1932).

(2) Where the decree holder claims to be entitled to cause the decree to be executed against any person other than such a person as is referred to in sub-rule (1), Clauses (b) and (c), as being a partner in the firm, he may apply to the Court which passed the decree for leave, and where the liability is not disputed, such Court may grant such leave, or, where such liability is disputed, may order that the liability of such person be tried and determined in any manner in which any issue in a suit may be tried and determined.

(3) Where the liability of any person has been tried and determined under sub-rule (2), the order made thereon shall have the same force and be subject to the same conditions as to appeal or otherwise as if it were a decree.

(4) Save as against any property of the partnership, a decree against a firm shall not release, render liable or otherwise affect any partner therein unless he has been served with a summons to appear and answer.

(5) Nothing in this rule shall apply to a decree passed against a Hindu undivided family by virtue of the provisions of Rule 10 of Order XXX".

6. Section 25 of the Partnership Act may also be referred to in this connection. "Every partner is liable to jointly with all the other partners and also severally, for all acts of the firm done while he is a partner", says the section.

7. The question in this case, to repeat, is whether the respondent who was a partner of the aforesaid firm during the accounting years relevant to Assessment Years 1962-63 and 1963-64 is liable to pay the arrears of tax due from the said firm notwithstanding his retirement from the said firm on and with effect from April 19, 1963. Before we answer this question, we may well ask which is the provision in the Act which says that the partners (i.e. continuing partners) are liable to pay the tax from the firm which is continuing. Neither Sri Ahuja, learned counsel for the Revenue, nor Mrs. Ramachandran, learned counsel for the assessee, could point out any provision stating expressly that the partners are liable to pay, whether jointly or severally, the tax due from the firm. It is true that the tax due from the firm will be recovered in the first instance by proceeding against the assets of the firm but it may happen that either the firm has no assets or the assets of the firm are not sufficient to satisfy the demand. In such a case, can the said demand be enforced against the partners, i.e., against persons who were partners during the period to which the demand relates and who are continuing as partners even at the time of the demand and recovery. Because there is no express provision in the 1961 Act making the partners liable for the tax due from the firm, it is not suggested by Mrs. Ramachandran - nor can it be suggested - that they are not liable. But then the question immediately arises, under which provision are they being made liable. The answer obviously is because of the very nature and characteristics of a partnership firm, as explained in various decisions of this Court (See *Addanki Narayanappa v. Bhaskara Krishnappa*, (1966) 3 SCC 400 : (AIR 1966 SC 1300) and *Malabar Fisheries Company v. Commr. of Income Tax, Kerala*, (1979) 120 ITR 49 : (AIR 1980 SC 176) and the provisions of the Partnership Act. In Malabar

Fisheries, this Court discussed the nature and character of the partnership under the Indian Law and held that "a partnership firm under the Indian Partnership Act, 1932, is not a distinct legal entity apart from the partners constituting it and equally in law the firm as such has no separate rights of its own in the partnership assets and when one talks of the firm's property firm's assets all that is meant is property or assets in which all partners have a joint or common interest". In particular, the Court held that Indian law in this respect is akin to English Law - and different from the Scottish law - and quoted several passages from Lindley on Partnership (12th Edn.) to indicate the relationship between the firm and the partners. The following passage from one of the extracts is relevant. It reads :

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

8. Section 25 of the Partnership Act expressly states that every partner is liable, jointly with all the other partners, and also severally, for all acts of the firm done while he is a partner. It is worthy of note that Section 25 does not make a distinction between a continuing partner and an erstwhile partner. Its principle is clear and specific, viz., that every partner is liable for all the acts of the firm done while he is a partner jointly along with other partners and also severally. If a continuing partner is liable to pay the tax due from the firm relating to the period when he was partner of the firm, we see no reason, in principle, to hold that the said liability ceases merely because a partner has ceased to be a partner subsequent to the said period. We do not think that the absence of a provision corresponding to the proviso to Section 46(2) of the 1922 Act in the present Act (we may remind that we are dealing with the provisions obtaining prior to April 1, 1989, i.e., prior to the introduction of Section 188-A) makes any difference to the position, since the liability of the partners to pay the dues of the firm does not arise by virtue of Order XXI Rule 50 of the Code of Civil Procedure, which is attracted by virtue of the said proviso, but on account of the basic premise mentioned hereinabove. Order XXI Rule 50 merely reiterates the said basic premises; it does not create a new liability.

9. In this connection, it would be relevant to refer to the reasoning of the Allahabad High Court in Sahu Rajeshwar Nath, (1964) 54 ITR 755, R.S. Pathak, J., speaking for the Bench, observed :

"It is true that under the Income-tax law a firm is treated as an entity distinct from its partners, but that is so only for the purposes of assessment. The procedure relating to assessment concludes when an assessment order has been made and the tax liability consequent upon that assessment had been determined. When a notice of demand is issued requiring the payment of the tax liability, the stage of assessment has been left behind, and with it the distinction between the firm and its partners..... The liability of the partners of the firm is joint and several, and it is open to a creditor of the firm to proceed to recover a debt of the firm from any one or more of the partners. In

Simon's Income Tax (2nd edition), Volume 1, page 337, paragraph 510, the law is thus stated :

The tax assessed in the firm name is a partnership debt for which all who were partners at the time when the debt was incurred, or who have held themselves out to the Revenue to be such, are jointly liable. This means that any or all of those persons may be sued for the whole of the tax due (when the assessment becomes final) without reference to their respective shares under the partnership agreement : See also *Stevens v. Britten* (1954) 3 All ER 385".

10. In our considered opinion, the aforesaid statement represents the correct understanding of law. In the appeal preferred against the said judgment (*Sahu Rajeshwar Nath v. Income Tax Officer*), the first contention urged by the appellant assessee before this Court was that unless a separate notice of attachment is issued in the name of the partner of the firm, the tax arrears due from an un-registered firm cannot be recovered from the partner. This contention was rejected by this Court. We are, however, not concerned with this aspect in this case and, therefore, we need not go into the question whether there is any distinction in this behalf between the 1922 Act and the present Act. No contention was raised in this case that no demand notice was served upon the respondent. We must presume that such a notice was served before attaching his properties. The second contention urged on behalf of the assessee in the said appeal was that since the certificate of recovery mentions only the arrears of tax due from the firm, they cannot be recovered from the partner. This argument was rejected with reference to the proviso to Section 46(2) of the Act which conferred upon the Collector the powers of a civil Court in the matter of recovery of the amount due under a decree. The Court also referred to Rule 50 of Order XXI in this behalf. And then observed: "In the present case, we see no reason why the Collector should not execute the certificate for demand of income-tax against the appellant who admits that he was a partner of the unregistered firm for the relevant accounting year It is manifest that the provisions of Order XXI, Rule 50(2) apply to the present case *mutatis mutandis* and since the appellant does not dispute that he was a partner of the unregistered firm for the relevant accounting year, the Collector could lawfully proceed to execute the certificate under Section 46(2) of the Act against the appellant and recover the income-tax arrears from him". The above observations cannot be read as holding that but for the proviso to Section 46(2), the arrears of tax due from the partnership cannot be recovered from the partner, for the reasons set out by us in *extenso* hereinabove. The liability of a partner to pay the dues of the partnership does not arise from Order XXI Rule 50 C.P.C. but from the very nature and character of a partnership firm.

11. We are also of the opinion that the discussion in the judgment of this Court in *Sahu Rajeshwar Nath* (AIR 1969 SC 667) in the para (beginning on 620 and ending on 621) dealing with the contention based upon Section 29 of the 1922 Act cannot be read as disapproving the reasoning of the Allahabad High Court, quoted by us *supra*. It is, therefore, not possible for us to agree with the reasoning of the Full Bench of the Kerala High Court - which has been adopted in the judgment under appeal - that where an assessment is made on the firm, the firm alone is the assessee and that any default in paying the tax assessed is that of the firm alone. It is also not possible for us to agree that merely because a separate assessment is made on the partner the liability imposed on the firm cannot be treated as the liability of the individual partners by importing the general principles of Partnership Act. In our opinion, this would be making a distinction between the firm and its partner, which is at variance with the accepted notions and, at any rate, does not follow from the decision of this Court in *Sahu Rajeshwar Nath*, (AIR 1969 SC 667). Similarly, the reliance by the Full Bench upon the decision of this Court in *Income Tax Officer v. Radha Krishan*, 66 ITR 590 : (AIR 1968

SC 46) is equally of no avail. That decision only says that tax due from one partner on his share income cannot be recovered from the other partner. To repeat, the firm is treated as an entity only for certain purposes. It is not a separate juristic entity distinct from its partners. A firm cannot be equated to a corporate body.

12. In this view of the matter, it makes little difference that Section 189 (3) is not attracted in the facts of the case to make the respondent liable.

13. We may mention that by virtue of introduction of Section 188-A with effect from April 1, 1989, the controversy of the present nature would not arise where the proceedings for recovery are initiated on or after April 1, 1989. Section 188-A reads :

"Joint and several liability of partners for tax payable by firm.

188A, Every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of this Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum".

14. This section explicitly provides what was implicit hitherto.

15. For the above reasons, these appeals are allowed. The judgment of the High Court is set aside. The writ petition filed by the respondent in the High Court shall stand dismissed. No order as to costs. Appeal allowed.