ALLAHABAD HIGH COURT

Hiralal Jagannath Prasad

Vs.

Commissioner of Income Tax

Income Tax Ref. No. 114 of 1963
(S.C. Manchanda and M.H. Beg, JJ.)

01.11.1966

JUDGMENT

Manchanda, J.

1. This is a case stated under Section 66(1) of the Indian Income Tax Act, 1922, (hereinafter referred to as the Act). The question referred is :

> "Whether on the facts and in the circumstances of the case, the firm was entitled to renewal of registration under Section 26A for the assessment year 1959-60 ?"

2. The material facts are these : The assessee Messrs. Hiralal Jagannath Prasad of Banaras, a Hindu undivided family concern, was carrying on business at Banaras, inter alia, in Kirana and money lending. A partial partition qua the aforesaid business was effected on the 17th of July 1948 and, on the following day, namely, 18th July, 1948, the members of the erstwhile Hindu undivided family formed themselves into a partnership for the purpose of carrying on the aforesaid business. An instrument of partnership was duly drawn up on 31st July, 1948 which was made operative from 18th July, 1948. According to the deed of partnership, which was in Hindi and an English translation whereof was annexed as annexure 'A' to the Statement of the Case, the firm consisted of six major partners. The opening paragraph of the deed mentions that the partnership deed is between the aforesaid six parties. The first party is Hira Lal. It is his son Ram Prasad who was admitted to the benefits of the partnership. The minor is not mentioned as one of the parties to the partnership deed. It is only in clause (3) of the deed that Ram Prasad is mentioned. That clause reads :

"3. That in the partnership business the share of the first party shall be 1/7th and

in the same way the share of each of the other partner shall be 1/7th and each party shall be entitled to get the profits and be liable to bear the losses according to his share and the parties have admitted Ram Prasad, minor son of Hira Lal Sahu, the first party, to the benefit of partnership according to Section 30 of the Indian Partnership Act and he also will get 1/7th share in profits of the firm." '

(Underlining (here in ' ') ours)
Clauses 7 and 9 of the deed run :

"7. That on the date when the parties commenced partnership business the capital of the parties in it was as given below and twelve thousand two hundred and thirty eight six annas one and half pies, belonging to the minor was also invested. It will be the duty of the parties to increase the capital so far as possible so that the partnership business may go on progressing and at all events no party will be entitled to withdraw any sum from the capital of the firm without the consent of the other partners :

1. Hira Lal Sahu First Party	Rs. 12,238/6/3
2. Jagannath Prasad Second Party	Rs. 12,238/6/1½
3. Ram Dass Third Party	Rs. 12,238/6/1½
4. Bhagwan Dass - Fourth Party	Rs. 12,238/6/1½
5. Gopal Dass - Fifth Party	Rs. 12,238/6/1½
6. Shiva Prasad - Sixth Party	Rs. 12,238/6/1½

8. That if any partner dies this partnership firm will not be dissolved but instead of the deceased partners his heirs will loin the firm as partners and if any of them be minor he will be admitted to the benefit of partnership under Section 30 of the Indian Partnership Act and the share of these heirs will be fixed out of the share of the deceased partner according to their shares."

3. The firm constituted under the said instrument of partnership was being registered from the assessment year 1950-51 upto the assessment year 1958-59. In other words the firm was considered to be genuine in all respects and the provisions of Section 26A were complied with. For the relevant assessment year 1959-60, for which the previous year was Asarh Sudi 12, Sambat 2015, the assessee filed an application for

renewal of registration under rule 6 of the Income Tux Rules. 1922. This application was signed by seven persons including the aforesaid Ram Prasad who had attained majority on the 6th of May, 1958, which fell during the relevant accounting period. A fresh instrument of partnership dated 5th June, 1958, was also drafted but that concerns the next assessment year and will not govern the proceedings for the registration or renewal of registration for the relevant assessment year. The Income fax Officer rejected the application for the reason that the partnership deed does not specify the allocation of the remaining 1/7th share of the loss since there was specific agreement that six major partners shall each be liable to the extent of 1/7th share of the losses. "Thus the liability of the major six partners of the firm was to the extent of 6/7th of the losses only. If the partners had not made specific agreement regarding the sharing of losses the alternative plea of the assessee could have been that the total losses of the firm will be shared by the major partners of the firm in the same proportion in which they were sharing the profits. But since there is a positive agreement that each major partner is liable to 1/7th of the loss only, the share of loss to the extent of remaining 1/7th remains unspecified. At any stage and in the eventuality of there being loss in the firm in any year any partner can disown the loss over and above the extent which is covered by 1/7th falling to his share according to the specific agreement in clause 3 of the said instrument of partnership." The registration was accordingly refused. The Appellate Assistant Commissioner confirmed the order of refusal. The Tribunal did likewise, holding that the registration was intended to confer benefits upon the partners and the conditions for obtaining such benefits required to be strictly complied with, and as there was no provision specifying as to who would bear the 1/7th share of the loss the partnership deed cannot be said to comply with the conditions under Section 26-A which requires the instrument of partnership to specify the shares of each partner. Hence this reference at the instance of the assessee.

4. The real question which arises in these cases is whether the firm which has applied for registration is a firm in existence and is constituted as shown in the instrument of partnership. This is what is provided in rule 4 of the Income Tax Rules which makes it obligatory upon the Income Tax Officer to grant registration by endorsing in writing at the foot of the deed of partnership that the firm is registered. In other words what Is to be considered is whether the firm is really genuine one constituted under a deed of partnership wherein the share of each partner is specified. Section 26-A of the Act requires an application to be made in the prescribed form to the Income Tax Officer

for registration on behalf of any firm which has been constituted under an instrument of partnership specifying therein the shares of partners. Under Sub-Section (2) of Section 26-A of the Act the application has to be made in the prescribed form and "it shall be dealt with by the Income Tax Officer in such manner as may be prescribed". The Rules prescribe the form of the application and the manner in which the application has to be disposed of. The material portion of these Rules is as follows :

> "2. Any firm constituted under an instrument of partnership specifying the individual shares of the partners may. under the provisions of Section 26-A of the Indian Income Tax Act, 1922, ...registered with the Income-tax Officer, the particulars contained in the said instrument on application made in this behalf.
> 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 with a copy thereof ....."

Form I is the form prescribed for an application for registration Paragraph 2 of the form requires a statement that the original instrument of partnership specifying the individual shares of the partners is enclosed. Paragraph 3 of the form reads :

> "3. We do hereby certify that the profits (or loss if any) of the previous .... year. .....will be divided or credited as shown in Section B of the Schedule . ." There is a foot note appended which reads :
> "Note - This application must be signed personally by all the partners (not being minors) in the firm as constituted at the date on which the application is made, or where the application is made after dissolution of the firm. by all person ? (not being minors) who were partners in the firm immediately before dissolution and by the legal representative of any such person who is deceased."

Thereunder is Schedule 'A' and then Schedule 'B' In column 1 of Schedule 'A' the names of all the partners are to be given and in column 6 the "share in the balance of profits (or loss) (annas and pies in the rupee) Then follows Schedule 'B' which only applies if the application is made after the end of the relevant previous year. This is followed by two foot-notes and it is note no. 2 which is material. This reads :

"(2) If any partner is entitled to share in profits but is not liable to bear a similar proportion of any losses this fact should be indicated by putting against his share in column 6 the letter "p" ".

Then follows rule 4 the material portion of which reads :

"4(1) 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 case may be, a certificate in the following form, namely :-
(2) It the Income-tax officer is not so satisfied, he shall pass an order in writing refusing to recognize the instrument of partnership, or the certified copy thereof, and furnish a copy of such order to the applicants.

5. It may be notified that in Section 2(6-B) of the Act it is provided that "firm", "partner" and "partnership" shall have the same meaning as the Indian Partnership Act, 1932, provided that the expression "partner" includes any person who being a minor has been admitted to the benefits of partnership. Section 4 of the Indian Partnership ship Act defines "partnership" as "between persons who have agreed to share the profits of a business carried by all or any of them acting for all." Under the charging Section 3 of the Act, a firm is made unit of assessment. Firms are then divided for purposes of the Act into registered and unregistered firms. An unregistered firm is taxed as a unit and so is a registered firm. But, under the provisions of Section 23(5) of the Act when the assessment comes to be made of a registered firm, though income tax payable by the firm itself is determined, after the amendment by Section 14 of the Finance Act, 1956, with effect from 1st April, 1956, nevertheless, under sub-clause (ii) of Section 23(5)(a) of the Act "the total income of each partner of the firm, including therein his share of its income, profits and gains of the previous year, shall be assessed and the sum payable by him on the basis of such assessment shall be determined. Provided that if such share of any partner is a loss it shall be set off against his other income or carried forward and set off in accordance with the provisions of Section 24.

6. The above provisions go to show what the scheme of the Act in the matter of registration of firms is. Although the income payable by the firm is to be determined,

no income tax was to be assessed and the share of each partner in the profit and loss has to be taken and assessed in the hands of each individual partner at the rate applicable to his total income. The Income Tax Department is not directly concerned with losses that any partner may incur. That is a matter which vitally concerns the partners of the firm. If the loss is not proved or determined, the loss will be carried forward and the partner will lose the benefit of set off against his other income being carried forward and set off against the income in the following year. It is in this background that the provisions of Section 26-A of the Act have to be considered. The object of Section 26-A of the Act, was only to prevent the firms which are bogus or colorable from obtaining the benefits there under and also to facilitate the Department in finding out exactly what the share of profit of each partner was, without having to hold another enquiry before apportioning those profits, and add them to the total income of the partner under Section 23(6) and assess him on such share of profit at the rate applicable to his total income. Therefore, the first requirement under Section 26-A was that there should be an instrument of partnership. In other words, there should not be an oral partnership and secondly that the partnership deed itself should specify "the individual shares of the partners." The Rules and in particular the prescribed form and the foot note make it abundantly clear as to what the phrase "specifying the individual shares" meant. In paragraph 3 of the form, under rule 3, it has to be certified what profits or loss, if any, will be divided or credited between the partners. In column 6 of the Schedule thereto what has to be set out is the sharp in the balance of profits or loss. Note (2) makes it clear that if there is any partner who is only to get the profits and not the losses, then in column no. 6 against his name only the letter 'P' is to be placed. In other words stress is only on the profits or loss, not on profit and loss. If it was intended that the share of every partner in profits as well as his share in the loss should also be set out then as pointed out by this Court in *Lakshmi Trading Co. v. Commissioner of Income Tax, I. T.* [1] column no. 6 could easily have been split up to provide one column for showing profit and the other for the share of loss of each partner. It was also pointed out that "no deed of partnership has been held to be invalid merely because the shares in profits are specified of all partners including those admitted merely to the benefits of the partnership, and there is no separate specification of shares of the remaining partners who are to share losses indicating their separate shares in the losses. Further, the rule and the form do not say that there should be any such calculation made by the assessee and entered in this form of application." Therefore, merely because the share of losses is not specified will not make the deed invalid so as to prevent its being registered and much less if the share

of losses has not been meticulously specified. In the present case, the Department and the Tribunal fell into the error of thinking that the share of the loss of each partner as specified was one-seventh. A fair and liberal reading of the partnership deed as a whole, and. in particular, clause (3) leaves no doubt that the share of loss of the six partners was not one-seventh. Clause (3) specifies the share of the partner in the profits as one-seventh but when it comes to bearing of losses the figure one-seventh is eschewed and in its place the words used are; "and will be liable to bear the losses according to share." Again, in that very clause, when it comes to the admission of the minor to the benefits of partnership it is provided. "He also will get 1/7th share in the profits of the firm." Before these words appear there it a specific reference to the provisions of Section 30 of the Indian Partnership Act. In these circumstances there can be no warrant for assuming, as the authorities below have done, that the share of the losses of the six partners was 1/7th.

7. Even assuming for the sake of argument that the share of losses was 1/7th that would not justify the rejection of the application under Section 26A of the Act for the reason that if the shares in losses are not specified the revenue does not stand to lose in any manner. It must be remembered that Section 26-A is essentially a provision for the protection of revenues of the State and to ensure that bogus firms do not obtain registration. The burden of proving any loss is on the firm or its partners. If the loss is not established or the proportion in which the loss has to be carried forward is not specified, then it is the partners who may lose the benefit to that extent by their inability to have the share of loss set off against their other income or to have it carried forward for being set off against profits in later years. That cannot be a legitimate ground for refusing registration to a firm. The provisions of Section 23(5)(a) and 23(6) of the Act are only for the benefit of the assessee and if he does not want that benefit, either by specifying the share in the losses correctly or specifying the share of losses at all then it is the partners thereof who will suffer and not the revenue. In this view of the matter we would, respectfully differ from the view taken by the Gujarat High Court upon which the learned Standing Counsel relied in *Thacker and Co v. Commissioner of Income-tax. Gujarat.*[2]

8. It only remains to observe that the manner in which we have interpreted the partnership deed is supported by two recent decisions of the Supreme Court. In *Commissioner of Income-tax Mysore v. Shah Mohan Dass Sadhuram* [3] the shares of the partners were not even specified and all that was agreed was that the profits and

loss will be "distributed pro rata" according to the proportion of the capital investment. The earlier case in *Commissioner of Income Tax. Bombay v. Dwarka Dass Khetan and Co* [4] was referred to and it was observed that : "But the facts in that case were that in the instrument of partnership Kanti Lal Keshar Deo was decried as a full partner entitled not only to a share in the profits but also liable to bear all the losses including the loss of capital. It was also provided that all the four partners were to attend to the business and if consent was needed all the partners including the minor had to give their consent in writing. The minor was also entitled to manage the affairs of the firm including the inspection of the account books and was given the right to vote, if a decision on votes had to be taken' ". Therefore, that case was a decision on its own peculiar facts. It was further observed; "It follows from the above discussion that as long as the partnership deed does not make a minor full partner, a partnership deed cannot be regarded as invalid on the ground that a guardian has purported to contract on behalf of a minor if the contract is for the purposes mentioned above . . It need hardly be stated that the partnership deed must be construed reasonably." In *Commissioner of Income Tax v. Shah Jethaji Phulchand*[5] the Supreme Court reiterated that the partnership deed must be construed reasonably.

9. On the facts of the present case, the partnership deed construed reasonably and as a whole cannot possibly lead to the conclusion that the minor was admitted as a full partner. It specifically stated that he was admitted subject to the provisions of Section 30 of the Partnership Act only to the benefits of partnership and that his share in the profits was one-seventh and not in the losses.

10. For the reasons given above the question referred is answered in the affirmative and in favor of the assessee. The reference is answered accordingly. The Department will pay the costs of the assessee which we assess at Rs. 250/- Counsel's fee is also assessed at Rs. 250/-

Reference answered accordingly.

Cases Referred.

1. Ref. No. 116 of 1962, D/d. 7-4-1966: (1966) 62. ITR (SN) 11 (All)
2. (1966) 61 ITR 540 (Guj)
3. (1965) 57 ITR 415

4. (1961) 41 ITR 52
5. (1965) 56 ITR (SN) 25