ANDHRA PRADESH HIGH COURT

Commissioner of Income Tax

Vs.

Rayalaseema Oil Mills

(P. Chandra Reddy C.J., Srinivasachari and Jaganmohan Reddy, JJ.)

09.03.1959

JUDGMENT

P. Chandra Reddy, C.J.

1. The question referred for the opinion of this Court is :

> "Whether on the facts and, in the circumstances of the case, the initiation of penalty proceedings and the penalty orders passed against the assessee, a dissolved firm for the assessment years 1947-48, 1948-49 and 1949-50 were illegal and bad in law."

2. This reference relates to penalties imposed upon the assessee under Section 28(1)(c) of the Income Tax Act (hereinafter referred to as the Act) for the assessment years 1947-48, 1948-49 and 1949-50. The assessee was a firm called Messrs. Rayalaseema Oil Mills, Tadpatri, which was engaged in the manufacture and sale of ground-nut oil. During the relevant accounting years, the assessee firm consisting of five partners was in existence but it was dissolved on 31-12-1949. The assessment for the three years was completed after that date. Having come to his notice during those proceedings that the assessee had concealed part of the income, the Income-tax Officer started penalty proceedings under Section 28(1)(c) of the Act by the issue of a notice under Section 28(3) for each of the three years and ultimately certain amounts were levied as penalties.

3. This was carried in appeal to the Appellate Assistant Commissioner before whom it was urged that, as this firm was not in existence at the time of the initiation of the penalty proceedings, it was not competent for the department to invoke Section 28(1) of the Act. This proposition was not accepted by the Appellate Assistant Commissioner with the result that the appeal was dismissed. In a further appeal to the Tribunal, this contention was repeated and it prevailed with Tribunal. The Tribunal accepted the appeal as it thought that the decisions of the Madras and Patna High Courts in *Raju Chettiar v. Collector of Madras*[1], and *Commissioner of Income Tax, Bihar and Orissa v. Sanichar Sah Bhim Sah*[2], respectively supported the contention of the assessee. At the instance of the Department, the Tribunal framed the question already referred to under Section 66(1) of the Act and forwarded it to this Court with

[1]1956-29 ITR 241

[2]1955-27 ITR 307: AIR 1955 Pat 103

a statement of the case.

4. The decision of this question turns on the interpretation of Section 44 of the Act. The power to levy a penalty is derived under Section 28 of the Act. Section 28, so far as it is material, says :

> "If the Income-tax Officer, the Appellate Assistant Commissioner (or the Appellate Tribunal) in the course of any proceedings under this Act, is satisfied that any person.
> x x x
> (c) has concealed the particulars of his income or deliberately furnished inaccurate particulars of such income, he or it may direct that such person shall pay by way of penalty, in the cases referred to in clauses (b) and (c) in addition to the tax payable by him, a sum not exceeding 1-1/2 times the amount of the income-tax and super-tax, if any which would have been avoided if the income as returned by such person had been accepted as the correct income."

5. There can be no doubt that if the assessee is found to have concealed or wantonly furnished inaccurate particulars he incurs the penal consequences contemplated by that section. The pertinent point for consideration is whether this section can be invoked in a case of dissolved partnership as in the instant case. That, in its turn, depends upon Section 44, which is in these words :

> "Where any business, profession or vocation carried on by a firm or association of persons has been discontinued, or where an association of persons is dissolved, every person who was at the time of such discontinuance or dissolution a partner of such firm or a member of such association shall, in respect of the income, profits and gains of the firm or association, be jointly and severally liable to assessment under Chapter IV and for the amount of tax payable and all the provisions of Chapter IV shall so far as may be, apply to any such assessment."

6. Unless this section attracts Section 28, the department cannot start penalty proceedings since it is only the latter section that enables the department to do so. Section 44 provides for fixing joint and several liability on persons who were partners at the relevant time to assessment in respect of the income, profits and gains. But does that provision also confer authority on the officers concerned to impose penalties on dissolved firms? Could the last part of the sentence in that section have the effect that is attributed to it by the Department? The answer of the Counsel for the Department is that such a power is implicit in that clause.

7. In support of this theory, reliance is placed on a judgment of a Bench of this Court in *Krishna Reddy v. Income-tax Officer, Tenali*[3], which was followed by a Bench of the Kerala High Court in *Abraham v. Income-tax Officer, Kottayam*[4], without any discussion. On the other hand, the stand taken by the counsel for the assessee is that Section 44 does not authorise the Revenue to impose penalties as Section 28 is

[3] AIR 1957 And Pra 368
[4] AIR 1958 Ker 93

inapplicable to a case falling under Section 44 and calls in aid *Veerappan v. Commissioner of*

Income Tax[5]*,* which dissented from AIR 1957 Andhra Pradesh 368. The principle of AIR 1958 Madras 8 was followed by the Mysore High Court in *Sadianna Shetty v. 2nd Additional Income-tax Officer*[6]*,* The learned counsel for the assessee urges that the law stated in the second set of rulings is correct and that AIR 1957 Andhra Pradesh 368 requires reconsideration.

8. The main point for decision is whether there is warrant for the contention that Section 28 is attracted to Section 44. In dealing with this question, Subba Rao C. J., who spoke for the Court, observed that Section 44 took in Section 28 which is one of the sections included in Chapter IV and consequently gave power to the department to invoke Section 28(1) of the Act. In the opinion of the learned Judge, the cases which dealt with Section 25-A had no application to Section 44, as the former section did not contain the words "all the provisions of Chapter IV shall, so far as may be, apply to any such assessment".

9. What we have to consider is whether such a power could be implied from the sentence "all the provisions of Chapter IV shall so far as may be, apply to any such assessment" in Section 44, which empowers the department to impose penalty and whether that provision distinguishes the latter section from Section 25-A. Section 25-A deals with the assessment after partition of a Hindu undivided family. These provisions were the subject of judicial scrutiny and it has been decided in 1956-29 ITR 241 and 1955-27 ITR 307 : AIR 1955 Patna 103 that neither Section 44 not Section 25-A allows the imposition of penalty on the members of an erstwhile Hindu joint family. This view has been consistently held by several of the High Courts.

10. In *Subba Rao v. Commissioner of Income Tax*[7]*,* Subba Rao C. J. and Ansari J. concurred with this opinion. It can, therefore, be taken to be settled that Section 25-A does not authorise the department to levy penalty under Section 28 of the Act. The problem then is whether different considerations apply to the construction of Section 44. This depends upon the scope and ambit of the last clause in Section 44 extracted above. It is urged by Sri M.S. Ramachandra Rao, Counsel for the Department, that the use of the word 'assessment' in that provision denotes that the legislature intended to vest such a power in the department. According to him, it is a word of wide amplitude and includes penalty also. This is founded on the following observations of their Lordships of the Privy Council in *Commissioner of Income-tax, Bombay Presidency and Aden v. Khemchand Ramdas*[8]*,*

> "One of the peculiarities of most Income-tax Acts is that the word 'assessment' is used as meaning sometimes the computation of income and sometimes the determination of the amount of tax payable and sometimes the whole procedure laid down in the Act for imposing liability upon the tax payer. The Indian Income-tax Act is no exception in this respect."

11. We do not think that this passage lends any support to the contention of Sri Ramachandra Rao. It only means that the assessment may not only be the

[5] AIR 1958 Mad 8 [7]1957-31 ITR 867: AIR 1957 And Pra 113
[6]1958-33 ITR 692 [8]65 Ind App 236

computation of the income or the determination of the amount of tax payable but it may have reference to the whole procedure prescribed in the Act for levying liablity upon a taxpayer. That does not, in any way, indicate that it embraces penalty. The liability referred to in our opinion,

could have reference only to liability to pay the tax and not the penalty. In this opinion of ours, we are reinforced by the judgment of Chagla C. J. who spoke for the Bench in the *Commissioner of Income Tax v. Jagdishprasad Ramnath*[9], Says the learned Chief Justice, after adverting to the remarks of the Privy Council already extracted :

> "But, in our opinion, it is clear that when the Privy Council referred to imposing liability upon the tax-payer, the liability was the liability to pay tax and not liability to pay a penalty. Mr. Kolah has been at pains to satisfy us that the imposing of a penalty under the Act is as much a penalty as the imposing of tax and if an assessee denies his liability to pay penalty, he is denying his right to be assessed under the Act. We are unable to accept that contention. The distinction between a tax and a penalty is clear, and the main object and the main purpose of a taxing statute is to lay down a machinery for the recovery of tax."

12. A Bench of the erstwhile Hyderabad High Court had also occasion to consider the scope of the passage in the judgment of the Privy Council in the cited case. In *Messrs. Bhikajee Dadabhai and Co. v. Commissioner of Income Tax*[10], they expressed the same opinion as in 1955-27 ITR 192 . It was laid down by the Hyderabad High Court that 'assessment' would not include 'penalty'. It is true that they were dealing with the applicability of Section 13(1) of the Indian Finance Act but the principle is the same and that would govern equally the situation arising under Section 44. Therefore, the judgment of the Privy Council cited above is not of much avail to the department.

13. The distinction between assessment and penalty is a well-marked one and it has been kept up throughout the Act. We may now examine some of the provisions of the Act to see in what sense these terms have been used. Section 18-A(9) contemplates the initiation of penalty proceedings if it appears in the course of any proceedings in connection with assessment that the assessee has committed some of the defaults mentioned therein. This denotes that assessment and penalty are two different concepts. Different provisions are made under Section 30 for appeals against assessments and against penalty. This distinction also appears from Section 31 (3).
The proviso to that section says that the Appellate Assistant Commissioner shall not enhance the assessment or penalty unless the appellant has had reasonable opportunity of showing cause against such enhancement. If the word 'penalty' is included in 'assessments', the legislature would not have used two different words. The same idea is conveyed by Section 34 also.

14. It is also worthy of note that while Sections 45 and 46 of the Act deal with recovery of the tax payable, the procedure for the recovery of penalty is contained in Section 47. This latter section, which is in contradistinction to recovery of tax under Section 46, provides for the recovery of any sum imposed by way of penalty under

[9] 1955-27 ITR 192
[10] ILR (1956) Hyd 899

the various provisions, which are set out there and also interest payable under the provisions of Section 18-A. All these provisions show that the legislature kept in mind this distinction and that is the reason why they took care to employ two different expressions, and made it plain that the word 'assessment' cannot be construed to mean the penalty also. In this context, *Commissioner of Income-tax, Madras v. Muthukaruppan Chettiar*[11], is apposite. It was remarked by the Full Bench

of the Madras High Court that the word 'assessment' is used in the Act in two senses, the process of determining the amount of profit or loss and the process of levying tax but if there is nothing repugnant in the context, the word refers to the former.

15. Another argument advanced by Sri M.S. Ramachandra Rao was that the proceedings for the levy of penalty are a part of the assessment proceedings and if the assessment could be made in regard to income of the dissolved firm, it is equally permissible to impose penalty, if such a course is warranted by the conduct of the firm as penalty proceedings arise out of assessment proceedings. We cannot accede to this proposition. The levy of penalty is not a necessary concomitant of the assessment proceedings. The assessment proceedings may lead to the imposition of penalty but that is not the same thing as saying that assessment proceedings always involve levy of penalty. The mere fact that discovery of concealment or of any of the defaults indicated in Section 28 is made in the course of assessment proceedings and that might result in the impost of penalty, the latter cannot be regarded as part of the assessment proceedings. The assessee is not liable to pay penalty unless he is guilty of any of the derelictions mentioned in Section 28. So, imposition of penalty is not necessarily involved in assessment proceedings.

16. Apart from these considerations, a close scrutiny of the terms of Section 44 shows that the section did not vest authority in the department to resort to Section 28, while making an assessment under that section. Section 44 talks of the income, profits and gains of the firm etc., being assessed. Therefore, its applicability is limited to the assessment of the income, profits and gains as envisaged in Section 4 of the Act. The income, profits and gains of the assessee are taxable under Section 4 read with Section 3 of the Act. Those two sections have no application to the levy of penalty.
Further, it is to be seen that Section 44 imposes two liabilities, one a liability to assessment in regard to the income, profits and gains and the other a liability to pay the amount of tax. The expression 'and for the amount of tax' throws a flood of light on the interpretation of that section. The partners of the quondam partnership are liable to pay only the tax as determined by the assessment. Indisputably, tax does not include penalty. This is made clear by Section 29. The liability is definitely restricted to the payment of tax determined by the assessment, If so, the word 'assessment' could not be read as meaning 'penalty' also. The notion that the department could levy a penalty while making an assessment under that Section would be inconsistent with the notion embodied in the words next following, 'for the amount of tax payable'. While the latter excludes the liability to pay anything other than tax, the former would include such a liability. This will introduce irreconcilia-bility between the two. It is a cardinal rule of construction that a statute has to be so interpreted as to harmonise each part of it. The collection of the words in the last part of the section clearly establishes that the assessment spoken of there, is in relation to the tax payable by the
[11]1939-7 ITR 29 (FB)
partners. The two expressions as used there interrelate to each other.

17. Further, the legislature has made it perfectly clear that the provisions of Chapter IV were applicable to such assessment, which in the context obviously refers to assessment mentioned earlier i.e., that in regard to profits, income and gains. Thus, the applicability of Chapter IV is limited to the computation of income or levy of tax. It is also to be borne in mind that Chapter IV is made applicable only as far as may be, which means as far as possible or necessary i.e. in so far as they govern the assessment of income, profits and gainst The provisions of Chapter IV

have to be extended to assessments under Section 44 for the reason that it is that chapter that devises the machinery for making the assessment and realizing the tax imposed.

18. It is because, the acceptance of the theory that the word 'assessment' comprehends penalty was beset with difficulties, and the Madras High Court has pointed out that there was a lacuna in Section 44, the legislature amended Section 44 recasting that section and inserting the word 'penalty' and thereby authorizing the department to levy 'penalty' even under Section 44. The section, as amended, runs thus :

> "44. (1) Where any business, profession or vocation carried on by a firm or other association of persons has been discontinued or where a firm or other association of persons is dissolved, the Income-tax Officer shall make an assessment of the total income of the firm or other association of persons as such if no such discontinuance or dissolution had taken place.
> (2) If the Income-tax Officer, the Appellate Assistant Commissioner or the Appellate Tribunal in the course of any proceedings under this Act in respect of any such firm or other association of persons as is referred to in sub-section (1) is satisfied that the firm or other association is guilty of any of the acts specified in clause (a), or clause (b), or clause (c) of sub-section (1) of Section 28, he or it may impose or direct the imposition of a penalty in accordance with the provisions of that Section.
> (3) Every person who was at the time of such discontinuance or dissolution a partner of the firm or a member of the association, as the case may be, he shall be jointly and severally liable for the amount of tax or penalty payable, and all the provisions of Chapter IV so far as may be, shall apply to any such assessment or imposition of penalty."

19. It is worthy of note that clause (2) of the amended Section 44 specifically deals with the imposition of penalty as distinct from the assessment spoken to in clause (1). Again, in clause (3), it is stated that the provisions of Chapter IV shall apply to assessment or imposition of penalty. This also indicates that the legislature thought that prior to the amendment, the word 'assessment' was incapable of being construed as including penalty.

20. Another circumstance that has a bearing in this enquiry is the requirement under Section 28 that there should be identity of the person, who concealed the particulars of the income with the person who is sought to be penalised. That identity cannot exist when the partnership that is said to be guilty of concealment, had ceased to exist. If the provisions of Section 28 are incorporated into Section 44, the 'individual partners' will be different from the one that is said to have suppressed the income i.e., the partnership. One of the reasons, that weighed with the Bench that decided 1956-29 ITR 241 in coming to the conclusion that 'penalty' could not be levied on the disrupted joint family was this factor viz., the non-existence of the joint family at the time when the penalty was sought to be levied. We may here extract the passage that contains the rule :

> "A Hindu undivided family is within the scope of the expression 'person' : see Section 2(9) of the Act. It was that 'person', the Hindu undivided family, that was the assessee. Section 28(3) requires that the assessee should be heard before an order is passed under

> Section 28(1). That assessee had ceased to exist when the order under Section 28(1) was passed in this case. That Balagurumurthy was heard before the order was passed, would not, in the circumstances of the case, satisfy the requirements of Section 28(2). We are referring to this aspect only to emphasize that there is no machinery provided by the Act to impose the penalty under Section 28(1) after the assessee had ceased to exist. Section 28(2) on the other hand, provided for the imposition of a penalty, but still the person to be penalised is not the registered firm; but the individual partner."

In 1957-31 ITR 867 already adverted to, Subba Rao C. J. and Ansari J., agreed with these observations.

21. On the foregoing discussion, it follows that Section 44 of the Act, as it existed, did not empower the Income-tax Department to resort to Section 28 of the Act. Several aspects of the controversy were discussed by the Madras High Court in AIR 1958 Madras 8 as also by the Mysore High Court in 1958-33 ITR 692 which have already been referred to. We are in agreement with the principle of these cases and we are unable to accept the doctrine of AIR 1957 Andhra Pradesh 368 as correct.

22. The reference is answered in favor of the assessee.

23. Another question that was debated was whether Section 44 applies to dissolved firms. Though this is not necessary for the disposal of the reference, we propose to deal with it, as it was argued at some length by Counsel on either side. The point presented by the counsel for the assessee is that Section 44 contemplates only discontinuance of the business and not dissolution of the partnership. Since the legislature was aware of this difference, it has employed different expressions with reference to a firm and an association of persons. In regard to the firm, the only condition necessary was discontinuance, while in respect of an association of persons, there should be a dissolution and throughout that section this differentiation is observed. There could be a discontinuance of business without the dissolution of the firm; for instance the business may be stopped and at the same time the firm may be continued for the purpose of collection of debts etc., proceeded the argument of the learned counsel for the assessee. The foundation for this submission is a passage in the judgment of Chakravartti J. in *R. N. Bose v. Manindra Lal Goswami*[12],

[12] AIR 1957 Cal 696 at p. 699

> "It is therefore arguable that the dissolution of a firm is not within the contemplation of Section 44 at all and therefore the department cannot invoke its aid for the purpose of assessing the income of a dissolved firm. Mr. Meyer agreed that if the department could not rely on Section 44 there was no other section in the Act, which would authorize it to assess the income of a dissolved firm; but he contended that discontinuance included dissolution. I am unable to accept that contention because although the dissolution of a firm must involve discontinuance of its business, the converse need not necessarily, be true and a firm may conceivably continue to exist after deciding to discontinue its business as firms very often do for various purposes, such as collecting their debts."

24. These remarks are merely obiter because the parties throughout proceeded on the footing that Section 44 applied to the case of a dissolved firm and the learned Judge himself has mentioned this. We express our respectful disagreement with these observations as the language of the section does not warrant this conclusion. Section 44, as it stood prier to the passing of the Income-tax (Amendment) Act, 1939, had not in contemplation an association of persons. By Section 49 of that Act, the present section 44 was substituted for the old Section 44. The words 'dissolved' and 'dissolution' were used with regard to an association of persons for the reason that there could be no continuance of their business of such an association, while the situation is different with regard to a firm. A firm may be discontinued and a new firm may come into existence in the eye of law and may carry on that business, in which case Section 44 would not come into operation. Thus, the legislature has emphasised the discontinuance of the business of a firm to indicate that, before that section could be invoked, there should be complete cessation of the business. See *B. M. Desai v. Ramamurthi, 1st Income-tax Officer*[13],

25. In discussing the scope of Section 25(3) of the Act, the Privy Council remarked in *Commr. of Income-lax v. Parson*[14], that the word 'discontinued' in Section 25(3) did not include the case of discontinuance of business by the person formerly carrying it on, as the result of the transfer or assignment of that business to another person who thereafter carried it on. The Privy Council approved of the *principle of Meyyappa Chettiar v. Commissioner of Income Tax, Madras*[15], and of *Commissioner of Income Tax v. Parson*[16], In the Madras case, the joint family business carried on by the members of the joint Hindu family was continued as a partnership by the members after severance in status. It was held that the partnership must be deemed to have succeeded to the business of the family and could be assessed to tax in respect of the income of the business for the previous year and the business could not be said to be discontinued so as to escape assessment on the income of the previous year. This case specifically dissented from the Bombay case already referred to.

26. It is clear from *Commissioner of Income Tax, Madras v. Chengalvaroya Chettiar*[17], that this section applies to the discontinuance of the business of a dissolved firm. The last sentence in the judgment bears out what we have said :

[13] 1958-34 ITR 409 [15] ILR 1944 Mad 166 [17] 1937-1 Mad LJ 182 : (AIR 1937 Mad 300 (SB))
[14] AIR 1945 PC 137 [16] ILR 1942 Bom 216

> "That being so, we are clearly of the opinion that the Income-tax authorities were correct in assessing the partners of the discontinued firm jointly and severally in respect of the profits earned by the firm before it was discontinued."

27. It may be mentioned that all the cases, which dealt with the proper construction of Section 44 are cases of dissolved partnerships and they all proceeded on the footing that the partnerships, which were discontinued, came within the mischief of Section 44. Quite apart from this, the contention for the assessee is untenable. If really Section 44 had contemplated only a case of business being discontinued while the firm is not discontinued, there is no necessity to seek the aid of Section 44. If the partnership continues to exist, it would be assessed as such and there is no question of making each of the partners of the firm jointly and severally liable. If a firm continues to exist, the firm as such could be assessed and in general law, the partners are jointly and severally liable. It is also significant that the section speaks of 'every person who was a partner of such a firm', the past tense indicating that there was no longer a firm. The language of the section is consistent only with the firm having been dissolved. For all these reasons, we

negative this contention of the counsel for the assessee.

28. As the assessee has succeeded on the main point, he will get his costs. Advocates' fee is fixed at Rs. 200/-.
Reference answered.