

KERALA HIGH COURT

United Hardwares

Vs

Commissioner of Income-Tax

(P Govindan Nair, C.J. G Vadakkal, J.)

10.08.1973

JUDGMENT

Govindan Nair, C.J.

1. The Income-tax Appellate Tribunal, Cochin Bench, has referred the following question for our decision : Whether, on the facts and in the circumstances of the case, the Tribunal is justified in law in holding that the assessee is not entitled to registration under Section 185 of the Income-tax Act, 1961 ? "

2. The relevant provisions of the partnership deed (annexure " A ") are Clauses 7 and 15. They read as follows :

" 7. The profits of the partnership business shall be shared and borne by the partners as under. Any loss sustained by partnership business, such losses are not binding on the 3rd partner.

Partner No. 1 : P. Kunhayin 40%
Partner No. 2 : K. Abdurahiman. 35%
Partner No. 3 : M. Avaran Koya. 25%
.....

15. In matters wherein no specific mention is made hereunder, the provisions of the Indian Partnership Act, 1932, shall prevail with respect to the relationship between the partners and the firm and third parties."

3. Chapter III of the Indian Partnership Act, 1932 (for short " the Act ") deals with " relations of partners to one another " and Chapter IV thereof deals with " relations of partners to third parties ". Though the wording in Clause 15 of the partnership deed is not very clear as to what are the provisions of the Indian Partnership Act that are intended to be made applicable it may not be unreasonable to construe that clause to refer to Chapters III and IV of the Partnership Act. So construed, the provisions in the Act dealing with "relations of partners to one another" will be attracted. The provisions in Section 13 of the Act can, therefore, be referred to. The relevant part

of that section is in these terms :

" 13. Subject to contract between the partners--.....

(b) the partners are entitled to share equally in the profits earned and shall contribute equally to the losses sustained by the firm ;....."

4. Assuming that this section is made applicable for governing the relationship of partners to one another, the further question arises whether by such provision in the partnership deed the requirement of Section 184(1)(ii) of the Income-tax Act, 1961, that " the individual shares of the partners are specified in that instrument " is satisfied.

5. The Supreme Court had occasion to consider the meaning of the word "specify" which occurred in Section 26 A of the Indian Income-tax Act, 1922, in *Kylasa Sarabhaiah v. Commissioner of Income-tax*¹, and observed thus :

" The word ' specify ' is used in Section 26A and Rule 2 as meaning mentioning, describing or defining in detail : it does not mean expressly setting out in fractional or other shares. In the deed of partnership, the shares are clearly defined, though they are not worked out in precise fractions."

6. Applying the principle enunciated in this decision, the Supreme Court construed the provisions in a partnership deed in the decision in *Parekh Wadilal Jivanbhai v. Commissioner of Income-tax*², The following extract from the judgment would be useful :

"On behalf of the assessee the argument was put forward that the High Court was in error in holding that the assessee was not entitled to registration under Section 26A of the Act. It was submitted that on a proper construction of the various clauses of the partnership deed dated March 19, 1950, it should have been held that the shares of the three individual persons in the profits and losses were clearly specified, namely, that each partner was allotted an equal one-third share and there was hence specification of the individual shares of the partners within the meaning of Section 26A of the Act. In our opinion, the argument of the appellant is well-founded and must be accepted as correct. It is evident that under Clause (3) of the partnership deed, the capital allotted to each partner is equal, viz., 5 shares of Rs. 16,000 each in a total capital of Rs. 2,40,000. Clause (10) states that ' after meeting all expenses, interest and other charges, the resulting net profit or loss shall be ascertained and shall be divided amongst all partners '. It should also be noticed that in all the applications for registration made by the assessee-firm under Section 26A of the Act the three partners have been shown to share the profits of the partnership firm equally. There is also the other circumstance that in the books of accounts for all the years, since its commencement from November 1, 1949, right up to date, the profits have been apportioned equally among the three partners of the partnership firm. Reading the partnership deed as a whole and in the context of the relevant circumstances of the case, we are of the opinion that there was specification of the individual shares of the partners in the profits within the meaning of Section 26A of the Act and the assessee-firm was entitled to registration for the assessment year in question."

7. It is thus clear, that the specification of the shares in the instrument of partnership is a necessary requirement for registration. Now turning to another decision of the Supreme Court it

is clear that if there is no such provision registration would not be granted. The decision is in *N.T. Patel & Co. v. Commissioner of Income-tax*³, The following extract from the judgment therein may be read :

" But in none of these clauses it is stated what the shares of the partners in the profits and losses of the firm were to be and that in our opinion was requisite for registration of the partnership under Section 26A of the Act and as that was wanting, registration was rightly refused,"

8. This court had occasion to consider whether in the absence of provision in the partnership deed regarding the proportion in which the losses are to be contributed by the partners, registration could be granted in *Commissioner of Income-tax v. Ithappiri & George*⁴, and it was ruled that registration could not be granted. One of us was a party to that judgment. We shall extract a paragraph from that judgment :

" The question is not whether there is any rule of law discernible either from Section 13(b) of the Indian Partnership Act, 1932, or from any general principle from which it is possible to discern the proportion in which the losses should be shared but as to whether Section 184 insists that this should be stated in the instrument. As we said the expression used in the section must normally cover both aspects of profits and losses. There is no compelling reason to read down the expression and give it a limited meaning."

9. The question arose in an earlier decision before this court in *C.T. Palu & Sons v. Commissioner of Income-tax*⁵ and the same view was taken therein. The provisions in the partnership deed which was constituted in *C.T. Palu & Sons v. Commissioner of Income-tax*⁵, were very similar to the provisions in the partnership deed now under consideration. The original deed of the 1st December, 1960, therein provided that the profit and loss of the business would be divided among the three partners in the ratio of 50 : 25 : 25. On the 26th March, 1963, there was another deed called a clarification deed which stated that the minor who was only a beneficiary entitled to 25 per cent. profit was not liable for the loss. This clarification deed did not provide in what manner the 25 per cent. loss which would have been borne by the minor as provided by the partnership deed of 1st December, 1960 (assuming the provision is valid in law which it does not appear to be) would be divided among the other two partners. In the absence of such provision it was ruled that the clarification deed did not satisfy the requirements of Section 184 of the Income-tax Act, 1961, and it was held that the firm was not entitled to registration.

10. Applying the principle of these decisions, the assessee-firm is not entitled to registration. Counsel for the assessee invited our attention to Section 48 of the Act and contended that Clause 15 of the deed read with Sections 13 and 48 of the Act would show that the shares in regard to losses have also been specified in the partnership deed. We may recapitulate that the partnership deed provided that the third partner shall not be liable for losses. Nothing more had been said in the partnership deed specifically regarding the manner in which the other two partners who take 40% and 35% of the profits should bear the losses. Section 13(b), the relevant part of which we have already read, cannot apply for more reasons than one. Section 13 as such will apply only when the question arises how the losses are to be borne by all the partners of a firm. When the partnership deed had excluded the liability for loss of one partner, the section cannot apply. Secondly, it is fairly well-established that when profits are to be shared in specified unequal

proportions and in the absence of a contract regarding the contribution of losses it must be presumed that the partners agreed to contribute to the losses in the same proportion as that in which they share the profits; In such cases it is not Section 13 that is applied. So, in the absence of an agreement regarding contribution towards losses between partners 1 and 2, they must be taken to have agreed to contribute to the losses in the same proportion, viz., 40: 35, This is not by virtue of Section 13. Confronted with this difficulty counsel for the petitioner-assessee contended that Section 48 of the Act must be applied. There are two difficulties in accepting this argument. The reference in Clause 15 of the partnership deed, qualified as it is by the wording of that clause, cannot attract Section 48. Secondly, Section 48 will apply only when the question of bearing losses on dissolution of the firm arises and will not apply as such to cases of sharing losses while the firm is continuing to carry on its business. No doubt, the principles of Section 48 have been applied by courts in determining in the absence of a contract or when Section 13 would not as such apply to determine the manner in which the losses should be borne. The decision in *K. Pitchiah Chettiar v. G. Subramanian Chettiar*⁶, is one such case. The principles that are embodied in the section itself were evolved by judicial decisions long before the Act and long before the English Partnership Act of 1890. In *Nowell v. Nowell*, [1869] 7 Eq. 538 the principle was applied. The partners had agreed to share the profits in a particular proportion. It was submitted that they must be taken to have agreed to bear the losses also in that proportion. The same principle was reiterated in the decision of the English Court in *In re Albion Life Assurance Society*, [1880] 16 Ch. D. 83 (C.A.). It may not be correct to say as it appears to have been said in some decisions that the principle which we have stated emanated from Section 48. It appears to us that Section 48 of the Act and Section 44 of the English Act are based on the judicial decisions which preceded the enactment of the sections.

11. Whatever that be, the question before us is not whether we can discern some principle or other for determining in what manner the losses should be borne by these two partners who are to take 40% and 35% of the profits but whether the partnership deed has specified that proportion. We find it difficult on the wording of Clause 15 to read into that clause, statements or intentions that the principle of the decision in *Nowell v. Nowell* or the one in *In re Albion Life Assurance Society* or for that matter the principle of Section 48 should be applied in dividing the losses. The deed is incomplete as far as the requirements of Section 184 are concerned regarding specifying the shares of losses. The provision applies to losses as much as to profits--see *Commissioner of Income-tax v. Ithappiri & George* already referred to--and that must be sufficient to refuse registration. The question referred to us will, therefore, have to be answered in the affirmative, that is, against the assessee and in favor of the department. We do so. We direct the parties to bear their respective costs.

12. A copy of this judgment under the seal of the High Court and the signature of the Registrar will be forwarded to the Appellate Tribunal as required by Sub-section (1) of Section 260 of the Income-tax Act, 1961.

Cases Referred.

1 [1965] 56 I.T.R. 219, 223 (S.C)

2[1967] 63 I.T.R. 485, 488 (S.C.)

3[1961] 42 I.T.R. 224, 228 (S.C.)

4[1973] 88 I.T.R. 332 (Ker.)

5[1969] 72 I.T.R. 641 (Ker)
6A.I.R. 1934 Mad. 494