BOMBAY HIGH COURT

J.C. Thakkar

Vs.

Commissioner of Income Tax, Central

Income-tax Reference No. 44 of 1954

(Chagla, C.J. and Tendolkar, J.)

18.02.1955

JUDGMENT

Chagla, C.J.

1. A rather unusual question arises on this reference. On the findings of fact to which we shall presently draw attention the assessee has been found to be a partner of an unregistered firm, and he has been assessed to tax on his share of profits in that firm. The unregistered firm has not been assessed and the contention of the assessee is that his assessment is illegal inasmuch as the unregistered firm of which he is a partner was not assessed to tax.

2. Now, it appears that the assessee at the relevant time was a director of the International Bank of India Ltd. The accounting year was from 1-4-1944 to 31-3-1945, and the assessment year is 1945-46, and in this year of account he and two others Nanjibhai Kalidas Mehta and Chunilal Khushaldas engaged in a joint venture to operate on the Stock Exchange, and as a result of this joint venture these three persons made a profit of Rs. 2,73,130. The assessee' s share out of this profit was Rs. 116543. It appears that Nanjibhai had an account in this bank, and as a director of this bank the assessee withdrew from that account a sum of Rs. 1,30,000 and credited out of this sum a sum of Rs. 1,16,543 to his account as his share of the joint venture. The case of the assessee was that there was no joint venture, that he was not a partner, that the amount that he had received, viz., Rs. 1,16,543 he had repaid to Nanjibhai and therefore he had made no profit which can be subjected to tax. On all these allegations put forward by the assessee he was disbelieved and the Tribunal found as a fact that there was a joint venture consisting of these three partners, that the partnership made a profit, that the share of the assessee was Rs. 1,16,543, that the assessee received the share and that the assessee was telling an untruth when he put forward the case that he had refunded the amount to Nanjibhai. Therefore, it is important to note that on these findings there is no dispute that the unregistered firm in which the assessee was a partner has made a profit, nor is there any dispute as to what his share in the profit is, nor is it

disputed that he had received that amount. There is also no suggestion that in the assessment he has been deprived of any deductions to which he would be entitled under the provisions of the Income-tax Act. He is not challenging the mode of assessment in the sense that any rights to which he would be entitled have been denied to him by the mode adopted by the taxing department. His only contention is that the assessment is illegal because a partner in an unregistered firm cannot be assessed to tax unless and until the unregistered firm of which he is a partner has first been assessed to tax, and it is that contention that we have to examine in the light of the Income-tax Act.

3. The first section to which we must look naturally is the charging section which is Section 3, and unless the Legislature has provided for a partner of an unregistered firm being liable to pay income-tax, the assessee's contention must be accepted. Now, as has often been pointed out, the assessable entity under the Income-tax Act is different from a legal entity. The object of, the Income-tax Act is to spread its net wide and to include in that net every person and every association of persons, however that association may have been constituted. Therefore we find that what is subjected to tax under Section 3 is the total income of the previous year of every individual, Hindu undivided family, company and local authority, and every firm and other association of persons or the partners of the firm or the members of the association individually. Therefore an individual can be assessed to tax, a partnership in which the individual is a partner can be assessed to tax, and Section 3 does not provide that when there is a partnership only the firm can be taxed and not the partners of that firm. Far from so providing, the section makes it clear that even where there is a firm which can be assessed to tax, a partner of that firm can also be an assessee for the purposes of the Act.

4. Mr. Palkhivala has emphasised the fact that the assessment to tax upon any one of these entities must be in accordance with and subject to the provisions of the Act. Therefore, not only must there be no prohibition in the Act against any one of these assessees being assessed to tax in any particular case but also the assessment must be in accordance with the provisions of the Act. But all that we wish to point out is that in the charging section itself, far from there being a prohibition against a partner of a firm being assessed to tax, there is a legislative fiat as it were in favor of the Income-tax department if they choose to assess a partner and not the firm of which he was a partner. Mr. Palkhivala says that Section 3 merely enumerates a class of possible assessees, and from that it is not possible to urge that in a particular case a partner is the proper assessee and not the firm. But if the intention of the Legislature was that whenever there is a firm, the firm should be assessed with regard to its profits and not the individual partners, we should have expected some indication to that effect either in Section 3 or in some other provision of the Income-tax Act, and,, as we shall presently point out, there is absolutely no prohibition in any provision of the Income-tax Act prohibiting the assessment of a partner until the firm of which he is a partner has been assessed.

5. Now, the assessee in this case can only succeed provided he satisfies us either that there is a

prohibition, express or Implied, against the mode of assessment followed by the Department or that there is an obligation cast by the statute upon the Department to assess the firm first and the partner afterwards or that the assessment of the unregistered firm is a condition precedent to the assessment of the partner. If the assessee fails to establish any of these conditions, it does not follow that even so the assessment would be upheld in every case. It would still be open to the assessee to contend that by adopting one mode of assessment rather than another a prejudice has been caused to him or that he has been deprived of some right to which he would have been entitled if the unregistered firm had been assessed first or that the burden of taxation has been increased because he has been assessed without the unregistered firm being assessed. It is needless to say that if one or more modes of assessment are open to the taxing authorities, the taxing authorities must adopt that mode which is more beneficial to the assessee. The Indian Income-tax Act is a taxing statute and therefore the Court must be zealous to see that no right which an assessee has under that Act has been taken away by any action on the part of the Department. Even though it may not be obligatory upon the Department to follow a particular procedure, the Court will insist upon the Department following the procedure if that procedure leads to a beneficial result as far as the assessee is concerned and the procedure followed by the Department is prejudicial to the assessee. But in such a case it would be a question of each individual assessee and the rights of each individual assessee.
Where there is a prohibition or there is an obligation or a condition precedent, no question of prejudice can arise nor is the question of prejudice relevant. If there is a prohibition, the taxing authorities cannot act contrary to the legislative mandate. If there is an obligation, the taxing Department must carry out that obligation. If there is a condition precedent, the condition precedent must be satisfied. But in the absence of these provisions, as we have said, it would then be for us to scrutinize each case of assessment, and if the assessee contends that prejudice has been caused to him, then it would be for us to consider whether the assessment should be upheld or not.

6. Perhaps it will be better to deal with the point of prejudice straightway. As far as this assessee is concerned, it is not suggested, and it cannot be suggested, that any prejudice whatever has been caused to the assessee by the mode of assessment adopted by the taxing authorities. We have a case here, very unusual, of the assessee complaining of the unregistered firm not being assessed when throughout these proceedings he stoutly maintained that there was no firm and that he was not a partner and that he never earned profits as a partner. It is not a case where the assessee goes to the Department and says "I am a partner of a firm, the books of the firm are there, assess the firm according to the procedure laid down in the Act, ascertain its profits or losses and then proceed against me on that basis." It is not even suggested by Mr. Palkhivala that in this particular case notwithstanding the attitude taken up by the assessee, if the Department had assessed this unregistered firm and ascertained its profits, any benefit would have accrued to the assessee. It is not said that by assessing the firm the profits shown as appertaining to his share would have been reduced or that he would have been entitled to claim any deduction which he has not been entitled to by reason of the fact that he has been assessed as an individual and his

share in the profits of the unregistered firm has been included in his assessment. Therefore the only question that has to be considered in this reference is whether in law the taxing authorities are prevented or prohibited from assessing the partner of an unregistered firm without assessing the unregistered firm itself.

7. Mr. Palkhivala concedes, after having taken us through all the relevant sections, that he cannot lay his finger on any express prohibition; but what he maintains is that when we look at the scheme of the Act it will be clear that there is an implied prohibition against the procedure followed by the taxing authorities. We have looked at all the sections to which attention has been drawn by Mr. Palkhivala and as we shall presently point out these sections do undoubtedly in certain cases make it clear that certain rights would be taken away from a partner of an unregistered firm if the unregistered firm was not assessed before the partner himself was assessed.
But it seems to us that that would be a case of prejudice in a particular specific instance with regard to which it would be possible for us to give the necessary relief to the assessee. But those sections to which we will now proceed to refer do not contain any express prohibition against the procedure followed by the authorities, nor in our opinion it would be legitimate to infer from these sections an implied prohibition against the action taken by the taxing authorities.

8. In the first place attention is drawn to the definition of the "previous year" contained in Section 2(11)(ii) and what is pointed out is that in the case of a partner of a firm the "previous year" in respect of his share of the income, profits and gains of the firm must be the same as the previous year determined for the assessment of the income, profits and gains of the firm. Now, it is clear that the object of this definition was to prevent the assessee from having a separate previous year in his own assessment with regard to his share of the profits of a firm of which he was a partner. Undoubtedly, some support is given to Mr. Palkhivala's argument by the fact that the expression used by the Legislature is "as determined for the assessment of the income, profits and gains of the firm". But there would be no difficulty in determining the previous year of a firm of which the assessee was a partner without necessarily subjecting the firm to assessment. But, in our opinion, it would be over-emphasising the importance of this definition which deals with a limited subject and of which the object is clear, to suggest that the only inference that can be drawn from this definition is that there is an implied prohibition against the individual partner being assessed before the unregistered firm is assessed.

9. Then attention is drawn to Section 10(2), and it is pointed out that many of the deductions referred to in that sub-section could only be claimed by the firm if the firm was an assessee, and if the firm was not an assessee, the partner would be deprived of those deductions because he could not claim those deductions in his own assessment. That is very true. But again the answer is that if in any case the assessee could satisfy us that by not assessing the firm the partner was deprived of any of the benefits to which he was entitled under Sub-Section (2) of Section 10 through the assessment of his firm, we would certainly not uphold such an assessment.

10. The next section is Section 14(2)(a). That section merely provides that a partner of an unregistered firm is not liable to pay tax in respect of his share of profits in that firm if the tax has already been paid by the firm. This neither helps one contention nor the other. This provision is reconcilable with the view that it is not necessary to assess the firm before assessing the partner. It is equally reconcilable with the other view put forward by Mr. Palkhivala. The obvious object of having this provision is that although a partner in an unregistered firm has to show for the purpose of rate and for the purpose of his total income his share in the profits of an unregistered firm, if the unregistered firm has already paid tax on the profits, he should not be made to pay tax over again.

11. Then it is pointed out that Section 16(1)(b) lays down how the share of a partner has to be computed and the share of the partner would not only include his share in the profit but would also include "salary, interest, commission or other remuneration" payable to him by the firm and that his share in the profit must be computed after deducting from the profit any interest, salary, commission or other remuneration paid to any partner. It is argued that this could not be done unless the assessee was the firm and the profits of the firm were assessed in the assessment of the firm itself. Here again if in assessing a partner as an assessee it is found that the share of the profits in the firm which is being assessed to tax would be less, if the procedure laid down in Section 16(1)(b) was followed, then undoubtedly the partner would have a cause for complaint and he would be prejudiced by the procedure followed by the department.

12. Attention is then drawn to Section 18(5) which confers the right of grossing up and the deduction of tax, and it is stated that if any shares or securities were owned by the firm, the partner would be deprived of that right. It is also pointed out that a partner of an unregistered firm would have no right to carry forward and set off the loss of the previous year. Now, these are all instances of actual prejudice which might be caused in particular instances, and as we have already observed these are cases which must be dealt with when they arise and relief should be given if we are satisfied that the procedure followed is a procedure which is likely to add to the burden of taxation of the assessee.

13. Then we come to the real section which deals with the assessment of a firm and that is Section 23(5). It is important to note that Section 23(5) only applies when the assessee is a firm. It has no application when the assessee is a partner of a firm or an individual. Therefore if the Department is assessing a partner of a firm as an assessee, that partner cannot require the Department to follow the procedure laid down in Sub-Section (5) of Section 23 except on the plea that it will be beneficial to him. But if the assessee is a firm, then undoubtedly the procedure laid down in Sub-Section (5) has got to be followed.
But it will be noticed that even if the assessee is a firm, sub-Clause (a) of that sub-section only deals with a case of a registered firm and certain rights are given to the partners of a registered firm and sub-Clause (b) of that sub-section only deals with a case where the Income-tax Officer

comes to the conclusion that if the firm had been assessed as a registered firm under sub-Clause (a) then the tax payable by individual partners would be more advantageous to the revenue. But neither sub-Clause (a) nor sub-Clause (b) deals with a case of an assessment of an unregistered firm as such and no special procedure is laid down as to how an unregistered firm should be assessed. Therefore for the assessment of an unregistered firm the provisions of Section 23 as in the case of any other assessee have to be followed. Therefore it is difficult to understand how the assessee in this case can receive any assistance by relying upon the provisions of Sub-Section (5) of Section 23.

14. Now, it may be pointed out that it would be indeed very foolish on the part of the Department in ordinary cases not to assess an unregistered firm but to assess a partner of an unregistered firm the unregistered firm has to pay tax on its profits. The tax is not allocated to each one of the partners. Therefore from the point of view of the rate ordinarily it is much more advantageous to the revenue to assess the unregistered firm. That is precisely because registration is considered an important right conferred upon a firm. But there may be cases where the Department may find it difficult to establish the identity of the unregistered firm or to establish a contract of partnership or where there may be a denial on the part of the assessee himself that he is a partner in a firm. It is difficult to understand why in such cases the Income-tax authorities should be deprived of their right to proceed against the assessee who may ultimately be found to be a partner of an unregistered firm.
The whole argument of Mr. Palkhivala comes to this that although his client denied that he was a partner, although he insisted upon being assessed as an individual, merely because the ultimate finding was that he was a partner and that he had made profits out of a joint venture, he should not have been assessed at all until the unregistered firm had been assessed. In our opinion the Income-tax Act advisedly and clearly gives an option to the Income-tax authorities either to assess the unregistered firm and then proceed to assess each individual partner of that firm or not to assess the unregistered firm at all but to assess each individual partner and his share of the profits in the firm for his assessment.
But, as we have said before, the choice must be carefully exercised and the Department must always remember that in exercising the choice it is not in any way prejudicing the assessee or depriving him of the right or adding to the burden of taxation which he has to pay.

15. Therefore, in our opinion, the assessment made in this case is not illegal. The question put to us is not with reference to any provision of the Act but is widely framed whether the assessment is legal or not, and as we do not find any illegality in the assessment arising out of any provision of the Act we must declare the assessment to be legal and answer the question submitted to us in the affirmative. The assessee to pay the costs.
Answer against assessee.