

# **BOMBAY HIGH COURT**

Chhotalal Devchand

Vs.

Commissioner of Income-Tax

I.T. Ref. No. 83 of 1957

(M.C. Chagla, C.J. and S.T. Desai, J.)

24.03.1958

## **JUDGMENT**

### **M.C. Chagla, C.J.**

1. This is not the first instance in which the Taxing Department has insisted on adherence to the letter of the law and overlooking the substance. But in this case it has excelled even itself. We are concerned with a question of registration and Mr. Joshis contention is that Section 26A is a technical section, it must be construed technically, it must be administered technically, irrespective of the injustice it may do. We realize that the Income-tax Act is a technical Act and questions of equity cannot be incorporated in construing the provisions of the law. But even the Income-tax Act must be construed according to some principles of commonsense. Even the Income-tax Act must be construed so that the Court, as far as it can possibly do so, construe a section in favor of the assessee and against the Department where in so construing it does not deprive the Department of revenue and it saves the assessee from a palpable injustice.

2. Now the facts are that the assessee firm sought registration and it was denied registration by all the three authorities - the IT.O. the A.C.C. and the Tribunal. It was in existence and registered under the Indian Income-tax Act from 1945 and the registration which was refused was for the assessment year 1954-55. It is rather significant that it is conceded by the Department that the partnership which is sought to be registered is a genuine partnership. It is conceded by the Department that every document on which the assessee relies for the purpose of registration is a genuine document; and yet it is urged that because of a certain aspect of law which was not present to the mind of the Department for all these years, it is entitled to refuse registration in the assessment year 1954-55. Undoubtedly, if the law permits the Department to go back upon an accepted position from 1945 that the partnership was entitled to be registered, then it can do so. But we must very carefully scrutinize the provisions of the law before we come to the conclusion that it is open to the Department under the circumstances of this case to refuse registration to the assessee firm.

3. Now, the partnership deed under which the firm was previously registered was dated 13th September, 1945 and that partnership continued till the 6th of November, 1953. The previous

year, or the accounting year for the assessment year 1954-55, is the Samvat year 2009, 19th October, 1952 to 6th November, 1953. A new partnership deed was executed on the 22nd of January, 1954. This was in respect of a new partnership that came into existence on the 7th of November, 1953. The old partnership was altered by a change in the constitution of the firm. There was a further change in the constitution of the firm and a third partnership deed was executed on the 29th of November, 1954. This change came about by reason of the fact that one of the partners died. Now the assessee firm applied for registration on the 19th of February, 1954 and it made a second application for registration on the 27th of November, 1954 and it is with this second application that we are concerned. To this application it annexed the partnership deed of the 29th of November, 1954. The application for registration was signed by the six partners who were partners of the firm under the deed of the 29th of November, 1954 and the schedule to the application for registration mentioned the names of the partners of the firm which was sought to be registered, their shares in the profits and losses and also the names of the partners who constituted the firm at the date of the application for registration and also their shares in the profits and losses. We may also point out that, although this application is dated 27th of November, 1954, it was actually presented on the 30th of November, 1954, so that it was based on the partnership deed of the 29th of November, 1954.

4. Under Section 26A the firm that is to be registered is the firm which is to be assessed for the year of account; and the instrument of partnership must be the instrument of partnership which constitutes that firm. Therefore, we must first turn to the partnership deed which constituted the firm which was in existence in the Samvat Year 2009 and in respect of which the registration was sought. This partnership deed dated the 13th of September, 1945 recites that the agreement of partnership is being arrived at between three parties and the three parties are the partnership firm of Karsondas Premji, the partnership firm of Chhotalal Devchand and an individual by the name of Padamsey Premji. But it is important to note that in the recital the names of the four partners constituting the firm of Karsondas Premji and the names of the two partners constituting the firm of Chhotalal Devchand are set out and it is equally important to note that the partnership deed is signed by all the seven partners. Clause 4 of the partnership deed provides that the capital of the partnership shall be contributed equally by the parties to the extent of Rs. 1 lakh by each of them. Clause 7 nominate; one partner each on behalf of the firms of Karsondas Premji and Chhotalal Devchand as the representative who will manage those partnership businesses. Clause 8 provides that the partners shall divide the profits and bear the losses in equal shares; and Clause 11 provides for arbitration, which includes arbitration between a partner and the executor or administrator of another partner. Now, when the assessee made the application on the 27th of November, 1954, it did not annex the partnership deed of the 13th of September, 1945, but it is common ground that that partnership deed was already on the file. The assessee only annexed to its application the partnership deed of the 29th of November, 1954. The Tribunal has refused registration on four grounds and we now proceed to consider each one of these four grounds.

5. The first ground on which the Tribunal has refused registration is that the firm is constituted of the two firms and one individual and hence it is not a valid partnership in the eye of the law. Obviously, in coming to this conclusion, the Tribunal had in mind the decisions of the Supreme Court reported in *Dulichand Laxminarayan v. Commr. of Inc.-Tax, Nagpur*<sup>1</sup>, The view taken by the Supreme Court on the facts of the case it was considering was that a partnership could not be constituted between three firms, a Hindu undivided family and an individual and that such a partnership could not be registered under Section 28A. Now, an

important and significant feature of that case was that the partnership deed was not signed by the individuals who constituted the three firms or the individuals who constituted the Hindu undivided family. Therefore, on the face of the partnership deed, an attempt was made to constitute a partnership of three types of entities a firm, a Hindu undivided family and an individual. Now it is clear law that you may have a partnership between a firm and an individual in the sense that the real partnership is not constituted between the individual and the firm, but between the individual and the aggregate of persons who constitute the firm. In other words, a partnership deed, instead of setting out the names of the individual and the partners of the firm, may compendiously use the name of the firm by making it clear that what was intended was a partnership constituted between the individual and the constituent members of the firm and this intention can be made absolutely clear if the partnership deed itself is signed, not only in the name of the firm, but by all the partners who constitute the firm. In the learned commentary on the Law of Partnership by Mr. Justice Desai, the principle of law is very succinctly set out at page 18 as follows :-

"..... .It is true that a firm is not a legal person, but it does not follow that a partnership which purports to exist between a firm and some other person is rendered impossible or becomes illegal on that ground. The view which the court takes in such a case is that the firm is nothing but an association of individuals and that when such' an association under a firm name enters into partnership with another individual it is not the aggregate that combines with the individual but the individuals composing that aggregate. The same consideration applies to the case of a firm which purports to enter into partnership with another firm. What in fact and in law takes place is that the partners composing one firm join with partners composing another firm as individuals and thereafter all of them carry on business in some collective name". Now, the Supreme Court judgment in Dulichands case 1956-29 ITR 535 : AIR 1956 Supreme Court 354, came up for consideration before a Bench of this Court in *Commissioner of Income Tax v. Shantilal Vrajlal*<sup>2</sup>, and at page 907 it was observed in the judgment as follows :-

"It is perfectly true that the Supreme Court has pointed out that a firm is not a person and that a firm cannot enter into a partnership with an individual because the Partnership Act requires that the contract of partnership must be constituted by persons deciding to carry on a partnership. Therefore, to the extent that this partnership deed set out as partners two firms and two individuals, the firm constituted under this partnership deed could not be registered. But it will be incorrect to suggest that the Supreme Court has laid down that the constituent members of a firm cannot enter into a partnership with an individual."

In our opinion, on a true reading of the partnership deed in this case, it is the constituent members of two firms and not the two firms as entities that have entered into the partnership with the individual; and this fact is amply borne out, as already pointed out,

<sup>1</sup>1956-29 ITR 535: AIR 1956 SC 354

<sup>2</sup>1957-31 ITR 903

both by the recitals and the fact that the partnership deed has been signed by the constituent members of the two firms. The provision with regard to arbitration, as pointed out by Mr.

Palkhivala, also lends support to this view, because the intention was clear that there should be arbitration in case of dispute, not only between the firms on the one hand and the individual on the other, but between each individual partner or his executor or administrator. Therefore, in our opinion, the Tribunal was in error when it took the view that the partnership constituted by the partnership deed was not a valid partnership.

6. The second ground on which registration has been refused is that, so far as the books of the assessee are concerned division of profits has been made, not to the seven partners by opening their capital accounts, but between the two firms and one individual. Now in the application for registration the shares of the partners are set out; but what is urged against the assessee is that in its books of account it has credited the profits to the firm name and not to the name of each constituent of the firm. Now if the shares of the partners are known - and I for the purpose of this argument we will assume that the shares are known - then it is merely a matter of arithmetical computation. Mr. Joshi is right that the purpose of insisting on profits being allocated to individual partners in the books of account of the partnership is to work out the provisions of Section 25(4) by which, in the case of a registered firm, the tax is levied not upon the profits of the registered firm, but on the share of each partner in the registered firm. This question also came up for consideration before this Court in the case of 1957-31 ITR 903 (Bom) and there we held that the mere fact that in the account-books of the partnership the profits were not taken into the accounts of the constituent members but were only taken into the accounts of the two firms and the two individuals partners was immaterial as the partnership deed clearly showed how the profits were to be divided between the constituent members of the two firms and ascertainment of the exact amount due to each of the constituents was merely a matter of arithmetical calculation.

7. The third ground which has been strongly pressed by Mr. Joshi is that the partnership deed does not specify the individual share of the partners. Now it is perfectly true that under Section 26A it is the instrument of partnership which must specify the shares of the partners and unless the instrument of partnership so specifies, the firm cannot be registered on the basis of that instrument of partnership. What is urged here is that the partnership deed specifies the shares of the partners as equal. In other words, the two firms and the individual had equal shares in the profits. But says Mr. Joshi, we do not find in the deed of partnership what is the specific share of each of the partners constituting the two firms. Now an instrument of partnership may be constituted by one or several documents. What Section 26A requires is that the documents which constitute the instrument of partnership must specify the shares of the partners. Let us first take a simple case before we come to the facts of this case. Two partners may draw up a partnership deed setting out the capital to be brought by the partners, the work to be done, the terms of the partnership, but they may not mention in this document the shares of the partners. They may draw up another document in which they may only specify the shares. Now both these documents together would constitute the instrument of partnership and from this instrument of partnership one could gather both who the partners are and what their shares are. In this case it is an admitted fact that there is a partnership deed constituting the partnership of Karsondas Premji and also a partnership deed constituting the firm of Chhotalal Devchand and both these partnership deeds are on the file of the Department. By looking at these two partnership deeds one would know what the shares of the partners are in these two partnerships and from these shares one would equally well know what the shares of these partners are in the partnership in question. The assessee actually drew the attention of the Department to these two partnership

deeds, contending that the shares were specified if one looked at the partnership deed of the 13th of September, 1945 and also the two partnership deeds of the firms of Karsondas Premji and Chhotalal Devchand. But Mr. Joshi contends that these shares must be specified in the partnership deed of the 13th of September, 1945 itself and if the shares are not specified then the firm cannot be registered; and for this purpose strong reliance is placed upon a passage in the judgment of the Supreme Court in 1956-29 ITR 535 : AIR 1956 Supreme Court 354.

Now what the Court there stated is at the bottom of page 542 and at page 543 (of ITR) :-

"..... .In order to be entitled to the benefit of registration under the Act, it will have to be shown that the shares of all individuals partners are specified in the deed and that all the partners have personally signed the application for registration as required by Section 26A of the Act read with R. 2." With very great respect to the Supreme Court, we take it that when the Court speaks of shares being specified in the deed, they are referring to the instrument of partnership in the language used by the Legislature in Section 26A; and again with respect, we entirely agree that these shares must be specified in the instrument of partnership. But we do not read these observations to mean, as Mr. Joshi wants us to, that the shares must be specified in one document along with other terms of partnership. So long as the terms are specified in any document which goes to constitute the instrument of partnership the condition of Section 26A is satisfied. You may have only one instrument of partnership, in which case all the terms must be found in that instrument. But you may have more than one instrument and if all the terms of the partnership and the shares of the partners can be gathered from various documents, then so long as the assessee is relying on these documents, there is no reason why the Department should refuse to look at any other document than the partnership deed and also there is no reason to hold that the terms of Section 26A have not been complied with. We had an identical question to consider in the unreported judgment in *Industrial Stores Co. v. Commissioner of Income Tax*<sup>3</sup>, There the partnership consisted of the Industrial Stores Co. which was shown as a partner with a share of 8 annas and two other partners with a share of the remaining 8 annas. There was another partnership deed constituting the Industrial Stores Co. and in that partnership deed the shares of the two partners were shown; and what we pointed out was that, if these two documents were read together, it would be clear as to what the respective shares of the partners were. In that case the assessee did not rely upon the partnership deed of the Industrial Stores Co. and even so, we held that the assessee was entitled to registration and we further pointed out that the instrument of partnership may be constituted by several documents and so long as the several documents constitute the partnership and specify the individual shares of the partners, those documents can be looked upon as the instrument of partnership which would entitle the applicant firm to registration. Mr. Joshi says that the authority of this decision has been shaken, if not completely impaired, by the decision of the Supreme Court just referred to. But as we have pointed out, the Supreme Court was not considering at all the question of more than one document

<sup>3</sup> I.T. Ref. No. 32 of 1955, D/-23-2-1956 (Bom)

constituting the instrument of partnership. There was only one instrument of partnership before the Supreme Court and all that the Supreme Court said was that, if the shares were not specified in that instrument, that instrument of partnership could not entitle the assessee to seek registration of the firm under Section 26A.

8. We may also refer to the judgment of the Calcutta High Court to which we have also referred in the Industrial Stores Co.'s case and that is reported in *Haridas Premji v. Commissioner of Income-tax, Bengal*<sup>4</sup>. In the Calcutta case the partnership was constituted by letters and a multiplicity of documents and the Full Bench there went to the length of asking the department to get a partner to write a letter accepting the terms of the partnership, to allow the registration application to be amended and to direct registration on the basis of the documents already before the Court plus the letter which the partner had written. It might almost be said in that case that the Court was making a new contract for the partners and on the basis of the new contract was ordering registration. We do not know what Mr. Joshi would have said if we had followed the course the Calcutta High Court followed. But without going to that length and only considering the documents which are before us and which were before the Department, it is clear that from these documents all the terms of the partnership emerge and there is no doubt as to what the specific shares of each individual partner is. The position would have been entirely different if there was no partnership deed constituting the two firms which are referred to in the partnership deed of the 13th of September, 1945. Then it could well have been urged that the shares are not specified in any document. The position might also have been different if no reliance was placed by the assessee on the partnership deeds of these two firms although in the unreported judgment we showed indulgence to the assessee. But when we have partnership deeds of these two firms, when they are actually on the file, when they are relied upon by the assessee and when from them the shares of the partners can be ascertained, it is idle to suggest that the instrument of partnership does not specify the shares of the partners. It is technicality with a vengeance.

9. The fourth ground on which registration was refused was that the application as framed does not meet the requirements of the Act and the Rules. The Tribunal does not give us any reason why it thinks that the application does not comply with the provisions of the law and Mr. Joshi has not pointed out to us any flaw or defect in the application itself. The application is signed by the partners of the firm as it was constituted on the date of the application as required by law and the two schedules contain all the necessary information which has got to be supplied by a party applying for registration.

10. In our opinion, therefore, the registration was wrongly refused and we must answer the question submitted to us in the affirmative.

11. Commissioner to pay the costs.

Reference answered.

<sup>4</sup>(1930) 4 ITC 475