

BOMBAY HIGH COURT

Commissioner of Income-Tax

Vs

D'Costa Brothers

(V Desai, C.J. Y Tambe, J.)

14.09.1962

JUDGMENT

Tambe, J.

1. This reference arises out of the Tribunal's order granting registration to the partnership firm by reversing the orders of the income-tax authorities. The assessee is a partnership firm constituted under a deed of partnership of date March 5, 1954. The partners are the family members : five brothers and four sisters. Clause 7 of the deed of partnership provides :

"Net profits or losses of the partnership business arrived at after deducting the partners' salaries together with other business expenses shall be divided between the partners (as mentioned therein)."

2. In short each brother gets 3/23rd share and each sister gets 2/23rd share. We are here concerned with the assessment year 1954-55, the relevant accounting year is one ended on 31st March, 1954. This deed of partnership was executed during the course of the accounting year though not at its commencement. The assessee firm made an application year though not at its commencement. The assessee firm made an application for registration of the aforesaid partnership deed under section 26A of the Indian Income-tax Act in the prescribed form. In dealing with this application the Income-tax Officer found that household expenses amounting to Rs. 6,110 and Rs. 704 were debited to the profit and loss account of the firm. This, according to the Income-tax Officer, was not a business expense and, therefore, to that extent the profits made by the firm were reduced. This, according to the Income-tax Officer, resulted in no distributing the profits in accordance with the terms of the partnership deed. He, therefore, rejected the application of the firm for registration. The other ground, on which registration was refused was that the instrument of partnership was drawn up almost towards the end of the year. We are, however, not concerned with the second ground on which the application was rejected. The assessee appealed against this order to the Appellate Assistant Commissioner, who agreed with the Income-tax Officer in his view that the sharing of trade profits not having been properly

made, registration could not be granted to the assessee firm. Assessee took a further appeal to the Tribunal. The Tribunal allowed the appeal and directed that the deed of partnership be registered. In its order it observed :

"We would like to add that the genuineness of the firm has yet not been doubted by the income-tax authorities in spite of the household expenses being debited to the profit and loss account. If the firm is genuine merely debiting personal expenses of partner to the profit and loss account before the profits are divided would not be tantamount to not dividing the profits of the firm in accordance with the terms of the partnership deed."

3. In this view of the matter, it granted the application of the assessee for registration of the partnership deed. At the instance of the Commissioner of the Income-tax, the Tribunal had drawn up a statement of case of referred to this court the following question of law as arising out of its order :

"Whether in distributing the profits of Rs. 29,895 ascertained after debiting partners' household expenses of Rs. 6,814 (Rs. 6,110 plus Rs. 704) to the profit and loss account, it could be said that the assessee has failed to distribute profits according to the shares specified in the partnership deed ?"

4. Mr. Joshi, appearing for the revenue, raised two contentions before us. Firstly, he contends that a deed of partnership describes the mode of ascertaining the profits. According to that mode the net profits or loss of the partnership business are to be arrived at after deducting the partners' salaries together with other business expenses. Household expenses cannot be treated as business expenses and debiting the household expenses to the profit and loss account is not in accordance with the terms of the partnership deed. True profits of the business, therefore, have not been determined and divided amongst the partners in accordance with the terms of the deed. The certificate granted by the assessee at the foot of the application thus being incorrect, the Income-tax Officer is entitled to refuse registration and has rightly done so. The Tribunal was, therefore, in error in granting registration. The second contention raised by Mr. Joshi is that particulars of apportionment of income, profits and gains (loss) of the business which the assessee is required to mention in Schedule B of his application has to be understood in the sense these terms are understood in the Income-tax Act. If the apportionment of profits shown by the assessee in Schedule B is not in accordance with the provisions of the Income-tax Act, then the certification made by the assessee in his application being incorrect, the Income-tax Officer is entitled to reject the application for registration, under rule 4 of the Rules framed under the Income-tax Act, on the ground that the application has not been properly made.

5. We find it difficult to accept these contentions of Mr. Joshi. It is first to be considered whether

it can positively be said that there had been any breach of the terms (term 7) of the deed of partnership in debiting the household expenses to the partnership expenses. There cannot be any doubt that under the provisions of the Indian Income-tax Act, household expenses cannot be allowed as a business expense, it being not an expenses wholly and exclusively laid out for the purposes of the business. But then we have here to construe not the import of the expression "business expenses" within the meaning of the Indian Income-tax Act, but we have here to see what the partners meant or understood by using the expression "business expenses" in their deed of partnership. Now, under section 11 of the Partnership Act :

"Subject to the provisions of the Partnership Act, the mutual rights and duties of the partners of a firm may be determined by contract between the partners, and such contract may be express or may be implied ..."

6. What the partners have been doing and what course had the partners been following in the conduct of their business is evidence of an implied agreement between the partners. The assessee has place before the Tribunal certain material and that material has been accepted by the Tribunal. This business was not for the first time started by the aforesaid members of the family in this assessment year, but the business was conducted by them even before, and at that time the aforesaid partners were taxed in the status of "association of persons". The assessee firm placed material before the Tribunal that even when the aforesaid members of the family had been doing business before and were taxed in the status of an "association of persons" or an unregistered firm, household expenses of all the partners had been similarly debited to the profit and loss account. The assessee also has placed on record material that subsequently also the household expenses have similarly been debited to the partnership account. Further the assessment orders under sub-section (3) of section 23 of the Indian Income-tax Act of the assessee firm, which is annexure "C" on the record, show that apart from the household expenses, the other private and personal expenses of the partners, such as car expenses, travelling expenses,

entertainment

expenses, repairs of the residential premises of the partners, charity expenses, repairs of the residential premises of the partners, charity expenses, were debited by the partners to the partnership account. The Income-tax Officer had taken no objection to the registration of the firm on the ground of debit of these expenses to the partnership account, but has taken objection only to the debiting of the household expenses as a ground for refusing the registration. The material on record, to which mention is made above, discloses that the "business expenses" as understood by the partners, was not in the sense as is understood under the Indian Income-tax Act.

7. Assuming for a moment that the inclusion of household expenses in the partnership expense was contrary to the terms of clause 7 of the partnership deed, it has to be considered whether that would entitled the Income-tax Officer to refuse registration. Section 26A deals with the

procedure in registration of firms. It provides :

"26A. (1) Application may be made to the Income-tax Officer on behalf of any firm, constituted under an instrument of partnership specifying the individual shares of the partners, for registration for the purposes of this Act and of any other enactment for the time being in force relating to income-tax or super-tax.

(2) The application shall be made by such person or persons, and at such times and shall contain such particulars and shall be in such form, and be verified in such manner, as may be prescribed; and it shall be dealt with by the Income-tax Officer in such manner as may be prescribed."

8. The requirements of the section thus are only three to entitle an assessee firm to claim registration :

(1) It must be a partnership constituted under an instrument of partnership;

(2) The instrument must specify the individual shares of the partners; and (3) The application for registration has to be in the prescribed form, giving all the particulars with a verification as required by the rules. The relevant rules 2 to 4 of the Rules framed under section 59 of the Act.

9. Rule 2 provides :

"Any firm constituted under an instrument of partnership specifying the individual shares of the partners may, under the provisions of section 26A of the Indian Income-tax Act, 1922 (hereinafter in these Rules referred to as the Act), register with the Income-tax Officer, the particulars contained in the said instrument on application made in this behalf.

Such application shall be signed by all the partners (not being minors) personally"

10. Rule 3 provides :

"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 ..."

11. The form prescribed under rule 3 consists of three paragraphs.

12. These paragraphs read :

"1. We.... beg to apply for the registration of our firm under section 26A of the Indian Income-tax Act, 1922, for the assessment for the income-tax year"

2. The original/... instrument of partnership under which the firm is constituted specifying the

individual shares of the partners together with a copy/.... is enclosed. The prescribed particulars are given in the Schedule below.

3. We do hereby certify that the profits (or loss, if any) of the previous year were/will be.... divided or credited as shown in section B of the Schedule and that the information given above and in the attached Schedule is correct."

13. The Preamble of Schedule B is in the following terms :

"Particulars of the apportionment of the income, profits or gains (or loss) of the business, profession or vocation in the previous year between the partners who in that previous year were entitled to share in such income, profits or gains (or loss). (Applicable where the application is made after the end of the relevant previous year)."

14. Rule 4 is in the following terms :

"(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"

15. The provisions of rule 4 are mandatory in terms. It casts an obligation on the Income-tax Officer, save and except when he is satisfied that there was no genuine firm constituted or in existence as shown in the instrument of partnership, or that the application for registration has not been properly made, to grant registration of the firm. We have already referred above to the form in which the application has to be made and it would be seen that Schedule B is not required to be filled in, every application, which is made, for registration. The Schedule is required to be filled in only if an application for registration is made after the end of the relevant previous year. The certificate as mentioned in paragraph 3 of the application, also shows that actual division of profits on the date of the application is not a condition precedent for the making of the application. It is not clear from the statement of the case whether the application in the instant case was made after the end of the relevant previous year. On the other hand, the copy of the Income-tax Officer's order under section 26A shows that the application for registration was made once on 30th of December, 1953, and another on the 5th March, 1954, i.e., before the expiry of the relevant previous year. Apart from it, the rules or even the Schedule does not state that the apportionment of profits of the partnership business has to be made after ascertaining and determining the profits either in accordance with the provisions of the Income-tax Act or strictly in accordance with express terms of the deed of partnership. The determination of profits by an assessee firm in a manner different from the provisions of the Income-tax Officer to reject the

application for certification of the deed of partnership on the ground that the application for registration has not been properly made within the meaning of rule 4. In what manner profits are to be determined and what deductions are to be allowed in the determination of the profits of the firm, is a matter entirely for the partners inter se to decide. It is even open to them, by consent of all the partners, to vary the terms relating to determination of profits. The provision of the Partnership Act does not come in their way to do so. On the other hand, section 11 in express terms provides :

".....such contract may be varied by consent of all partners, and such consent may be express or may be implied by a course of dealing."

16. On course, the determination of the profits made by the partners is not binding on the Income-tax Officer, and it is open to the Income-tax Officer to disallow such expenses as are not permissible under the Act and add back those amounts to the total income of the assessee, but in dealing with the application for registration that is not relevant. The requirements of law are that there must be an instrument of partnership under which the partnership is constituted; that it must specify the individual shares of the partners; that the application has to be in the prescribed form and must be signed by all major partners; if the application is made after the expiry of the relevant previous year, it must show the manner in which the profits of the business as determined by the partners have been distributed or would be distributed and that must be in accordance with the shares specified in the deed of partnership. Any error in the computation of profits by the partners in our view, does not give a right to the Income-tax Officer to reject an application for registration on the ground that the application for registration has not been properly made. We are, therefore, unable to accept the second contention of Mr. Joshi that the words "income, profits or gains" mentioned in Schedule B mean "income, profits or gains" as understood under the Income-tax Act, or that they must be understood to mean "income, profit and gains" as determined in accordance with the provisions of the Indian Income-tax Act. What the assessee is required to do under Schedule B is to furnish particulars of apportionment of income, profits and gains as made by him and does not require the assessee first to determine the profits and gains in accordance with the provisions of the Income-tax Act and then apportion them.

17. For reasons stated above, both the contentions of Mr. Joshi cannot be accepted.

18. In our judgment, therefore, the answer to the question referred to us must be in the negative. We answer accordingly. The Commissioner shall pay the costs of the assessee.

19. Question answered in the negative.

