

# ORISSA HIGH COURT

Rao and Sons

Vs

Commissioner of Income Tax Bihar

S.J.C. No. 40 of 1963

(R.L. Narasimham, C.J. and R.K. Das, J.)

05.12.1964

## JUDGMENT

**R.K. Das, J.**

1. This is a reference under Section 66(1) of the Indian income Tax Act, 1922, wherein the income tax Appellate Tribunal has referred the following question of law to this Court.

"Whether in the facts and circumstances of the case, registration under Section 26A was rightly refused on the ground that the individual shares of the partners, M. Subba Rao and his wife, Sita Debi were not specified in the partnership deed."

2. The Firm Messrs. Rao and Sons, was constituted under an instrument of partnership dated 31-3-51. The names of the partners and their respective shares in the firm were described as follows :

- (1) M. Venitateswar Rao . . . .Four annas
- (2) M. Kartik Chandra Rao .. Four annas
- (3) M. Satyanarayan Rao .. Four annas
- (4) M. Subba Rao and his wife, Sita Debi .. .. Four annas

Partners 1, 2 and 3 are the sons of partners 4, M. Subba Rao and 5 his wife Sita Devi. At the time of the execution of the deed, Satyanarayan Rao was a minor. On 4-1-1952, he became major and signified his assent to remain a partner of the firm and thus the partnership deed was validated with effect from that date. Applications for the registration of the firm under Section 26A of the Income-tax Act, 1922 thereafter referred to as the Act were made by the assesseees for the assessment years 1954-55, 1955-56, 1956-57 and 1957-58, but the same were rejected by the income Tax Officer mainly on the ground that the share of M. Subba Rao and his wife was not separately shown in the partnership-deed, but was jointly shown to be four annas.

Against the order of the Income-tax Officer, the assessee unsuccessfully carried appeals to the Appellate Assistant Commissioner as also to the Appellate Tribunal. The Tribunal relying upon a

decision of the Supreme Court reported in *Steel Brothers and Co., Ltd. v. Commr. of I. T.*, held that the specific share of each of the partners, namely, M. Subba Rao and his wife Sita Debi, was not shown in the Instrument of partnership and hence the firm was not entitled to registration under Section 26A of the income-tax Act. During the pendency of the appeal before the Tribunal, the new Act (Income-tax Act of 1901) came into force. Under Section 297(1)(c) of the new Act any proceeding pending before any Income tax authorities was allowed to be continued under the provisions of the Act of 1922. Though an application was made by the assessee under Section 256(1) of the new Act (corresponding to Section 66 of the Act of 1922), the Tribunal treated the same as one made under Section 68 of the Act and referred the aforesaid question of law to this Court with a statement of facts of the case. The present reference is confined to the assessment year 1954-55.

3. From the deed of partnership it is clear that M. Subba Rao and his wife Sita Debi have jointly been allotted four annas share in the partnership concern, though the other share-holders have each been given a share of four annas. Clause (k) of the partnership instrument is relevant for the purpose and it runs as follows :

"(k) That in case of the death of either of the partners 4 and 5 (M.S. Rao and Sita Devi) the survivor will be entitled to the whole of the share of partners 4 and 5, i.e., four annas."

None of the clauses of the instrument mentions a specific share being allotted individually either to M. Subba Rao or his wife. Clause (k) above quoted, makes it further clear that no specific share was meant to be given individually to either of the partners, and on the death of either of them, the survivor will be entitled to the full share of 4 annas. Between these two partners inter se there was no specification of share. Thus, there cannot be any doubt that so far as M. Subba Rao and his wife are concerned, the individual share of each of them has not been specifically stated in the deed.

4. Section 26A(1) of the Act requires that an application for registration may be made for the purpose of the Act by a firm constituted under the instrument of partnership specifying the individual shares of partners, and the application shall be in such form and be given in such manner as may be prescribed by the rules, in the application form prescribed under Rule 3, the specific share of each partner has also to be stated. Thus, such specification is obligatory both under the Act and the rules made thereunder.

5. Mr. Narasaraju, learned counsel for the assessee, however, contended that even though, the shares had not been specifically stated in the instrument of partnership, yet in view of the provisions of Section 13(b) of the Partnership Act, they shall each be held to be entitled to equal shares of two annas out of the joint share of four annas allotted to them. Section 13(b) of the Partnership Act runs as follows :-

"Section 13. Subject to the contract between the partners :

(a) .....

(b) The partners are entitled to share equally in the profits earned and shall

contribute equally to the losses sustained by the firm."

He urged that even though the shares of these two partners were not specifically stated, in view of the provisions of Section 13(b) of the Partnership Act, they shall each be deemed to hold, as between them, equal shares of two annas, and thus, the requirements of Section 26-A(1) were fully complied with even though in the partnership deed itself the shares of each of them were not specifically mentioned. He further contended that to determine the eligibility of the firm to be registered u/s 26A the Department was not justified in confining itself merely to the terms of the instrument of Partnership, but in case of any doubt or ambiguity, it could rely upon other records as well. He relied upon a decision of the Bombay High Court reported in *Chhotalal Debenand v. Commissioner of Income Tax Bombay*<sup>2</sup> in support of his contention. That, however, is not a case where the aid of Section 13(b) of the Partnership Act was taken to determine the shares of the parties. That was a case of partnership between some firms and individuals. No doubt their Lordships held that where from a true reading of the instrument of partnership and other necessary records available before the income-tax authorities the shares of different partners could be ascertained, merely on technical grounds that the shares have not been specifically stated, the application under Section 26A should not be rejected. They however, observed :

"We realise that the Income-tax is a technical Act and the 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 common sense, so that the court as far as it can be possible do so construe the section in favour 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. In the present case we are not aware whether the Department will stand to lose revenue in case the registration is allowed. But in ordinary circumstances, it would as a result of the registration, the income would be divided and will be liable to assessment in the hands of the individual partners."

Mr. D. Mohanty, learned counsel for the department, however, contended that in view of the provisions of Section 26A, the specification of shares is mandatory and the assessee firm would not be entitled to registration in the absence of any such specification of shares in the partnership deed itself, and the defect cannot be rectified with the aid of Section 13 (b) of the Partnership Act. He relied upon a later decision of the Bombay High Court reported in *Re Parekh Wadilal Jiwanbhai*. In that case, in none of the terms of the partnership deed individual share of the partners was specified and it was urged that by reason of Section 13 of the Partnership Act it may be held that those individual partners held equal shares. Their Lordships held :

"It is true that with the aid of Section 13 of the Partnership Act it is possible to hold that the partners are entitled to share equally in the profits, there being no agreement to the contrary in the deed, but that is not sufficient for the purpose of Section 26A. Section 13 of the Partnership Act can-not be called in aid for that purpose."

This decision of the Bombay High Court relied upon by the Department makes it absolutely clear that the provisions of Section 13 of the Partnership Act cannot be made applicable to cases under Section 26A of the Act.

6. Mr. Narasaraju relied upon the provision of Section 16(3) of the Income-tax Act which runs as follows :

"In computing the total income of any individual for the purpose of assessment, there shall be included;

(a) so much of the income of the wife or minor child of such individual as arises directly or indirectly :

(b) from the membership of the wife in a firm of which her husband is a partner."

and contended that since ultimately the income of the wife has to be added to the income of the husband in computing the total income of the husband, it is immaterial whether the wife's share is separately shown in the deed of partnership or not, and in any event the objection being technical in nature, the registration should not have been rejected.

7. Before their Lordships of the Supreme Court in the case reported in *Balaji v. Commissioner of Income Tax<sup>4</sup>, Officer, Special investigation Circle, Akola*, the consideration of the provisions of Section 16(3)(a)(i) came in different context, where the provision was challenged as imposing an unreasonable restriction on the fundamental right of the assessee under Article 19(1)(f) and (g) of the Constitution. Their Lordships observed that under that provision, an individual is taxed on the income of his wife or his minor children if he carries on business in partnership with his wife, or if he admits his minor sons to the benefits of the partnership: whereas an individual if he carries on business in partnership with a third party whether a man or woman or even with his major children or if he or his wife or child carrying on business separately he should be liable to pay the tax on his share of the partnership concern. They said that the purpose of the provision is to prevent the evasion of tax. In the present case even if the contention of the learned counsel is accepted, it is not possible to determine if the ultimate effect would not result in an evasion of tax.

8. It is however well-settled by authorities that the provisions of Section 26A have to be strictly complied with and non-specification of toe shares in the deed of partnership is itself a good ground for refusing registration under that section.

9. in a case reported in AIR 1958 SC 315 : 1958-33 ITR 1, their Lordships of the Supreme Court, were dealing with a case where one of the partners, viz. Burma who though was a party to the partnership agreement, had no individual share specified in the profit and loss of the combination; it was held that in order that an application for registration can be entertained by the Income-tax Officer and the partnership registered for the purpose of Section 26A of the Act read with the relevant Rules, it is necessary that the application should be signed by all the partners of the firm including Burma and should specify individual shares of the partners. Unless it is done, it would not be competent to the Income-tax Officer, to entertain the application and it would not be obligatory upon him to register the partnership for the purpose of this Act.

10. In a case reported in *N.T. Patel and Co. v. Commissioner of I.T. Madras<sup>5</sup>*, their Lordships found that in none of the clauses of the partnership deed the individual shares of the partners in profit and loss of the firm were specified. They were of the opinion that the specification of the

shares was a pre-requisite for registration under Section 26A of the Act, and that being wanting the registration was rightly refused.

11. In a Full Bench decision of the Madras High Court reported in *Kanniappa Naicker and Co. v. Commissioner of Income Tax, Madras*<sup>6</sup>, their Lordships took the view that a partnership cannot be registered as a firm under Section 26A of the Income-tax Act where the instrument of Partnership does not specify on the face of it, the individual shares of the partners. This view was also expressed in a later decision of the same High Court reported in *Guruswami Chettiar v. Commissioner of Income Tax, Madras*<sup>7</sup>, where it was held that the evidence regarding the shares of the partners offered within the four corners of the instrument used as the basis of the claim for registration should not be made to depend in a reference and scrutiny of a number of other documents either between the same parties or between the partners and other third parties. By using the expression "instrument of partnership" the Legislature confined the scope and jurisdiction of the proceeding for registration, under Section 26A to a consideration of the basic instrument and to that instrument alone. The object is to have a summary enquiry and precaution has therefore to be taken to limit the enquiry within as narrow a compass as possible.

12. The Patna High Court in a case reported in *Khimjee Waljee and Co. v. Commissioner of Income-tax, B and O*<sup>8</sup>, followed the aforesaid Full Bench decision of the Madras High Court reported in 1937-5 1TR 49, and held that the provision as to the specification of the shares in the deed enacted under Section 26A and the provision as to the specification of shares of each partner in the application form prescribed under rule 3 of the Rules made under Section 59 are mandatory in nature, and unless those provisions are strictly complied with, the partnership is not entitled to get itself registered, and it cannot be taken that if the shares of the partners are not specified, it should be taken in law that the partners have equal shares. Here as it appears, the Court declined to apply the provisions of Section 13 of the Partnership Act so as to determine the specific shares of Individual partners for the purpose of Section 26A.

13. The High Court of Andhra Pradesh in a case reported in *Kylasa Sarabhaiah v. Commissioner of Income Tax, A.P.*<sup>9</sup>, has also held that registration should be disallowed where the shares of the partners were not specified in the instrument of partnership itself.

14. The Mysore High Court in a case reported in *Uma Maheshwar Cotton Ginning and Pressing Factory v. Commissioner of I. T. Mysore*<sup>10</sup> also took the view that the deed of partnership having clearly shown the shares of various individuals constituting the partnership, the refusal to register the firm was improper.

15. The Saurashtra High Court in a case reported in *Patel and Co. Jamnagar v. Income Tax Commissioner Bombay North, Kutch and Saurashtra*<sup>11</sup> Baroda, observed that though for the purposes of ordinary law of partnership, the position may be different for the purposes of Section 26A of the Income-tax Act, it is necessary to specify the individual shares of each partner.

16. The Nagpur High Court in a case reported in *Jabalpur Ice Manufacturing Association v. Commissioner of Income Tax, Madhya Pradesh*<sup>12</sup>, held that unless the individual shares are defined the firm will not be entitled to registration under Section 26A of the Act.

17. The Lahore High Court in a case reported in *United Cotton Factory v. Commissioner of Income Tax*<sup>13</sup>, held that in the absence of specification of shares of individual partners, the firm is not entitled to be registered under Section 26A of the Act.

18. The Punjab High Court in a case reported in *Commissioner of Income Tax v. Kishorichand Hamjee Das*<sup>14</sup>, appears to have held the same view. They held that if from the deed of partnership the meaning is perfectly clear that the particular partners are entitled to a specific share, then there is no bar to registration under Section 26A.

19. Thus, the main plank of the learned counsel for the assessee is the case reported in AIR 1959 Bombay 152 stated above. But as I have already stated a later decision of the same High Court not taken different view. Apart from the decisions of the various other High Courts the aforesaid decision of the Supreme Court has clearly laid down that the specification of the individual shares in the instrument of partnership is one of the essential pre-requisite to entitle a firm to registration under Section 26A of the Act. Registration under Section 26A is a privilege given to a firm in order to enable individual partners to get the benefits of the lower rate of assessment where available. The right can be claimed only when the requirements of the Statute have been strictly complied with. We have already seen that the deed of partnership of the assessee-firm did not specifically mention the individual shares of M. Subba Rao and his wife M. Sita Devi and they were mentioned merely as the holders of a joint share of four annas. In view of the position of the law as stated above, I must hold that the requirements of the provisions of Section 26A of the Act have not been complied with to entitle the firm for registration, and accordingly the application has been rightly rejected by the Department. We therefore answer the question in the affirmative and hold that the registration under Section 26A of the Act was rightly refused by the Department.

The Department is entitled to costs of the Reference from the assessee. Hearing fee is assessed at Rs. 250/-.

**Narasimham, C.J.**

20. I agree.

Answer against assessee.

Cases Referred.

<sup>1</sup>33 ITR 1

<sup>2</sup> AIR 1959 Bombay 152 : 1958-34 ITR 351

<sup>3</sup>1961-42 ITR 266 (Bom)

<sup>4</sup> AIR 1952 SC 123

<sup>5</sup>AIR 1961 SC 1356

<sup>6</sup>1937-5 ITR 49 (SB)

<sup>7</sup>1963-48 ITR 692 (Mad)

<sup>8</sup>AIR 1954 Pat 396

<sup>9</sup>1962-46 ITR 470 (AP)

<sup>10</sup>1964-52 ITR 749 (Mys)

<sup>11</sup> AIR 1956 Saurashtra 11

<sup>12</sup>1955-57 ITR 88 (Nag)

<sup>13</sup>1957-32 ITR 117 (Lah)

<sup>14</sup>1962-44 ITR 622 (Punj)

