

PATNA HIGH COURT

Khimji Walji

Vs

Commissioner of Income Tax

Misc. Judl. Case No. 315 of 1951

(Ramaswami and Ahmad, JJ.)

17.03.1954

JUDGMENT

Ramaswami, J.

1. In this case the Income-tax Appellate Tribunal has referred the following question of law for the opinion of the High Court:

"Whether the firm constituted by the partnership deed dated 1-5-1931 could be registered in accordance with the provisions of Section 26A, Income-tax Act, and the rules made thereunder for the assessment years 1945-46, 1946-47 and 1947-48?"

2. By a document of partnership, dated 7-12-1916 there was a partnership firm started in the name of Khimji Walji and Company. There are two partners Khimji Walji with 10 annas share and Khora Ramji with 6 annas share. After Khimji Walji died his three sons, Purushotam, Panchan and Devram, acquired the 10 annas share of the partnership. Similarly, on the death of Khora Ramji his son Jeevram and grandson Dharamshi acquired his 6 annas interest in the partnership. On the 1st of May 1931 all these five members of the families of Khimji Walji and Khora Ramji entered into a new partnership called Khimji Walji and Company. Panchan and Devram were minors and the deed of partnership was executed on their behalf by their guardian Gangabai. In this deed of partnership the three sons of Khimji Walji were collectively shown as having 10 annas share and the heirs of Khora Ramji were also shown collectively for 6 annas share. After the two minor sons, Panchan and Devram, attained majority, applications were made to the Income-tax authorities for the registration of the firm. For the assessment years 1945-46 and 1946-47 two separate applications were made dated the 21st of November 1945 and the 24th of July 1946.

On the 1st of April 1947 a second deed of partnership was executed between these five persons. This deed affirmed the first deed of partnership and in addition specified the individual share of the five persons. Purushotam, Panchan and Devram were shown in this document as having three annas four pies share each and Jeevram and Dharamshi were shown as having 3 annas share each. For the assessment year 1947-48, an application for registration of the firm was made on

19-2-1948. The Income-tax Officer rejected all the three applications. As regards the first two applications the order of rejection was based upon the ground that the shares of the individual partners were not specified in the document of partnership and the applications under Section 26-A, Income-tax Act did not also specify the shares of the individual partners. The third application was rejected on the ground that the second deed of partnership was executed after the counting period had expired. The assessee preferred appeals to the appellate Assistant Commissioner but the appeals were dismissed. Appeals were further taken to the Income-tax Appellate Tribunal. It was argued on behalf of the assessee that the three sons of Khimji Walji, Purushotam, Panchan and Devram constituted a Hindu undivided family and the two heirs of Khora Ramji, Jeevram and Dharamshi, similarly constituted another Hindu undivided family and that the partnership was formed of these two Hindu undivided families whose shares were specified in the document. This argument was rejected by the Appellate Tribunal and the appeals preferred on behalf of the assessee were dismissed.

3. It is convenient in the first place to deal with the two applications made for the assessment years 1945-46 and 1946-47. On behalf of the assessee Mr. Dutt put forward the argument that the Income-tax authorities should have registered the partnership under Section 26A, Income-tax Act, though the shares of the individual partners were not expressly specified in the applications, or in the deed of partnership. Counsel pointed out that if the shares of the partners were not specified it should be taken in law that the partners have equal shares. In support of his argument, counsel referred to Section 13 (b) of the Partnership Act which states that:

"subject to contract between the partners, the partners are entitled to share equally in the profits earned and shall contribute equally to the losses sustained by the firm."

The argument of the counsel was that the Income-tax authorities should have held that in the eye of law the three sons of Khimji Walji had 3 annas 4 pies share each in the partnership. It was contended that the failure of the partner to mention the shares expressly in the deed of partnership and in the application forms was a mere procedural irregularity and the power of the Income-tax authorities to register the firm under section 26A was not affected. The question at issue depends upon the proper interpretation of Section 26A, Income-tax Act, which states :

"(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."

Section 26A makes it clear that the instrument of partnership should specify the individual shares of the partners and only a firm constituted under such an instrument of partnership should apply for registration under the Section. Section 26A(2), provides that the application shall contain such particulars and shall be in such form as may be prescribed by the rules. Rules have been

framed in this connection under Section 59, Income-tax Act. Section 59(5) states that the rules made under this section shall have effect as if enacted in Income-tax Act. In my opinion the provisions of Section 26A must be construed in the setting and context of the rules framed under Section 59 and other important provisions of the statute. Rule 2 states that any firm constituted under an instrument of partnership specifying the individual shares of the partners may register with the Income-tax Officer the particulars contained in the deed of partnership. The rule further requires that such an application should be signed by all the partners, not being minors, personally, and the rule also mentions at what point of time the application should be made. Rule 3 prescribes the form of the application. Paragraph 3 of the form requires a certificate that the profits or loss, if any, of the relevant period were divided or credited as shown in section B of the Schedule. Section B requires that particulars should be given of the apportionment of the income, profits or gains (or loss) of the business in the previous year between the partners who in that previous year were entitled to share in such income, profits or gains (or loss). Rule 4 says that if on receipt of the application, the Income-tax Officer is satisfied, that there is a firm in existence constituted as shown in the instrument of partnership and that the application has been properly made, he shall enter at the foot of the instrument a certificate stating that the instrument has been registered with him and it will have effect for the assessment year in question. Rule 4(2) states that if the Income-tax Officer is not so satisfied, he shall pass an order in writing refusing to recognize the instrument of partnership. All these provisions must be read along with Section 23(5) of the Act which lays down the procedure with regard to the assessment of a firm whether registered or unregistered. In the case of a registered firm, the sum payable by the firm itself shall not be determined but the total income of each partner of the firm including therein his share of its income, profits and gains of previous year shall be assessed and the sum payable by him on the basis of such assessment shall be determined. In the case of an unregistered firm, the Income-tax Officer may either determine the sum payable by the firm itself, or in the alternative, proceed in the manner laid down for a registered firm if he is of opinion that the aggregate amount of the tax payable by the partners under such procedure would be greater than the aggregate amount which would be payable by the firm and the partners individually if the firm were assessed as an unregistered firm. It is manifest that Section 26A and the rules framed under Section 59 and the particulars required to be stated in the form are all intended to facilitate assessment on registered firms in the manner provided under sub-section (5) (a) of Section 23 of the Act. It is highly important therefore that the real partners should be disclosed and the precise share of each of the partners should be mentioned both in the application and in the deed of partnership upon which the application is based. The object of the whole scheme will be defeated if it is found that either the partnership is not genuine or the shares mentioned in the deed of partnership are not correct. The provisions of Section 28(2) of the Act are also important. Section 28(2) provides that if the Income-tax officer is satisfied that the profits of a registered firm have been distributed otherwise than in accordance with the shares of the partners as shown in the instrument of partnership registered under this Act governing such distribution, and that any partner has thereby returned his income below its real amount, he may direct that such partner shall pay by way of penalty a sum not exceeding one and a half times the amount of income-tax and super-tax which has been avoided. The provisions of Section 28(2) are penal in character and these provisions cannot be properly enforced unless the deed of partnership and the application made under Section 26A make correct specification of the shares of each individual partner. In the light of these considerations I am of opinion that the provisions as to the specification of the shares in the deed enacted under Section 26A and the provisions as to the specification of the share of each partner in the application form prescribed under rule 3 are mandatory in nature and unless these

provisions are strictly complied with the partnership firm is not entitled to get itself registered under the provisions of Section 26A. It should be remembered in this connection that the registration of firms under the Income-tax Act is not a general right but it is a mere privilege given to the partnership in order to enable the individual partners to get the benefit of the lower rates of assessment applicable wherever such rates are lower than the rate applicable to the total income of the firm computed as a whole. If a firm desires to take advantage of this privilege, it must conform strictly to the requirements of Section 26A and the rules made under Section 59. My conclusion therefore is that the Income-tax authorities rightly rejected the applications made by the firm for registration under Section 26A for the years 1945-46 and 1946-47 in this case. The view that I have taken as to the construction of Section 26A is borne out by authorities. For example, in - '*Kannappa Naicker and Co. v. Commissioner of Income Tax*'¹, there was a partnership constituted of a smaller firm and some individuals and the deed of partnership while mentioning the proportion in which the profits and loss, were to be shared between the firm and the other partners respectively, did not specify the shares of the partners of the smaller firm which was a member of the partnership. The application for registration under Section 26A was refused by the Income-tax authorities on the ground that the deed of partnership did not specify the shares of the partners of the smaller firm. The action of the Income-tax authorities was upheld by a Full Bench of the Madras High Court. At page 320 the learned Judges state :

"The shares of the partners in M. K. Naicker and Sons were each Rs. 0-1-9 totalling 7 annas and as that partnership had previously been registered, a reference to the instrument relating to it, a copy of which was filed with the Income-tax authorities, would show this. Not only would the Income-tax authorities be aware of the shares of the partners - and it is conceded that they did know - but the application for registration itself set out the individual shares of the partners of M. K. Naicker and Sons. Notwithstanding this knowledge, the Income-tax Officer - and his action has been upheld by the Commissioner - presumably took the view that he was rigidly bound by the words of the section and that as in the instrument of partnership these individual shares were not given, registration must be refused.

The object in requiring this information is in order that the Income-tax authorities may determine what the profit received by each of the partners from the partnership profits is and in order to prevent the profits from being distributed to the partners otherwise than in accordance with the shares of the partners as shown in the instrument of partnership registered under the Act and to prevent any partner returning his income below its amount. We think that this is a hard case in view of the fact that Income-tax authorities were really aware of the shares of the partners; but the words of the sub-section do not seem to us to permit of any elasticity of construction. Section 28(2) also points to the same conclusion. The individual shares of the partners must be specified in the instrument of partnership. They were not. That being so, the Income-tax Officer could refuse registration on that ground."

4. I next turn to the question whether the assessee was entitled to registration under Section 26A for the assessment year 1947-48. It was submitted by Mr. Dutt on behalf of the assessee that in the application for this year the shares of the individual partners were specified. It was conceded by counsel that the deed of partnership dated 1-5-1931 has not specified individual shares of the

partners. It was however contended that the second deed of partnership dated 1-4-1947 mentioned the specific shares of the three sons of Khimji Walji and also of the heirs of Khora Ramji. It was also pointed out by counsel that both the deeds of partnership were submitted to the Income-tax Officer along with the application for registration under Section 26A. It was argued that there has been a compliance with the provisions of Section 26A and the Income-tax authorities had no justification for refusing to register the partnership firm. In my opinion the argument is not correct. It is necessary for the purpose of registration under Section 26A that the partnership should be constituted by an instrument of partnership and that such a partnership as is constituted under an instrument of partnership should have been in existence during the accounting year. It is clear that if the partnership was not in existence during the accounting year, it cannot be registered so as to affect the liabilities of the partners for income-tax accruing during the accounting period. In the present case the second deed of partnership was executed on the 1st of April 1947 and the document specifically states that the rights and liabilities of the partners, according to the new partnership, would take effect from 1-4-1947. This is expressly mentioned in paragraphs 3 and 4 of the deed of partnership which is printed at page 21 of the paper book. It is clear therefore that the partnership firm as constituted by the second deed of partnership dated 1-4-1947 was not in existence in the accounting year which expired on 31-3-1947. It follows that assessee was not entitled to have the second partnership deed dated 1-4-1947 registered under Section 26A. This view as to the interpretation of Section 26A is supported by important considerations. It is clear, as I have already pointed out, that the object of registration under Section 26A is to facilitate assessment of income-tax on registered firms in the manner provided under Section 23(5) of the Act. But this object cannot be carried out unless the document of partnership for the accounting year is produced for registration. In the second place, the language of Section 28(2) of the Act is also important. Section 28(2) empowers the Income-tax Officer to take action if he is satisfied in the course of any proceedings under the Act that the profits of a registered firm have been distributed otherwise than in accordance with the shares of the partners as shown in the instrument of partnership registered under this Act 'governing such distribution'. The language of Section 28(2) would also suggest that the deed of partnership that has to be registered under Section 26A is a deed of partnership relating to the accounting year. This conclusion is reinforced by a consideration of the rules framed under Section 59 of the Act. Rule 3 and the form for application for registration prescribed by that rule states that the particulars of the apportionment of income between the partners in the accounting year should be given. The provisions of the rule would suggest that the deed of partnership to be produced under Section 26A is the deed of partnership relating to the accounting year. Rule 2(e) provides that an application for registration may be made by all partners before or after the dissolution of the firm in respect of the assessment to be made on its income up to the date of dissolution. Rule 4 and rule 6A are also important. They make provision for registration of a firm that "is or was in existence". If an application is therefore made for registration of a firm that was in existence and has been dissolved after the accounting year, the deed that could be registered under Section 26A would not be the deed relating to the assessment year but would necessarily be the deed relating to the accounting year.

The matter is very well put by Mr. Sampath Iyengar :

"As the object is to assess individually the total income of the partners who in the accounting year were entitled to receive the same, there is no point in requiring the production of the instrument governing the partnership during the assessment year. If, for

instance, there were two partners A and B, sharing profits equally up to 31-3-1950 and thereafter in the ratio of 3 to 1 and the profits earned by the firm were an equal sum of Rs. 50,000 either for the year 1949-50 or for the year 1950-51, the income for charge during the assessment year 1950-51 would be Rs. 25,000 each. This would be evidenced only by the partnership deed for the account year 1949-50. The partnership deed for the assessment year 1950-51 would, on the other hand, show the respective incomes to be Rs. 37,500 and Rs. 12,500 which figures have no utility whatever in the assessment proceedings for 1950-51." (Indian Income-tax Act, 4th edition, page 846.)

In the light of all these considerations I have reached the conclusion that the second deed of partnership dated 1-4-1947 could not have been registered under Section 26A in the present case and the application for the assessment year 1947-48 made on behalf of the assessee was rightly rejected by the Income-tax authorities. A similar view as to the construction of Section 26A has been taken by the learned Judges of the East Punjab High Court in - '*Kalsi Mechanical Works, Nandpur v. Commissioner of Income Tax*²', In that case a firm was alleged to have come into existence by a verbal agreement in June 1944 but the instrument of partnership was drawn up only in May 1949, after the expiry of the relevant accounting year. It was held by the learned Judges that the firm was not entitled to be registered under Section 26A for the purpose of assessment for the year 1949-50.

5. For the reasons expressed, I hold that the firm constituted under the partnership deed dated the 1st of May 1931 was not entitled to be registered under Section 26A, Income-tax Act, for the years 1945-46, 1946-47 and 1947-48, and that the question referred to the High Court must be answered in favour of the Income-tax Department. The assessee must pay the cost of this reference: hearing fee Rs. 250.

Ahmad, J.

6. I agree.

Answer in the negative.

Cases Referred.

¹ AIR 1937 Mad 316 (FB)

² AIR 1953 Pun 301