

# PATNA HIGH COURT

Commissioner of Income Tax

Vs

Agardih Colliery Co

Misc. Judl. Case No. 277 of 1953

(Ramaswami and Banerji, JJ.)

31.01.1955

## JUDGMENT

### **Ramaswami, J.**

1. In this case the assessee is a partnership firm constituted under a deed of partnership dated 15-9-1944. The partners were Renu Bala Devi and Ratilal Manishankar Dave each having eight annas share. The object of the partnership was to carry on the business of coal mining and to deal in coal and coke. One of the clauses of the partnership deed was that neither of the partners should mortgage or charge his share in the assets or profits of the firm without the consent of the other partner. Later on, on 23-11-1945, there was another deed of partnership executed as between Ratilal Manishankar Dave and five other persons who were Deochand A. Mehta, Raja Khengarji, Shamji Mandan, Mulji Goabhai and Talewar Ram. By this document, it was agreed that eight annas share in the profits of the first partnership would be divided between the six partners who are mentioned in the second partnership deed. It was agreed that Ratilal Manishankar Dave would get two annas share and Deochand A. Mehta would get another two annas share, and the other four partners would be granted a share of one anna each. We are concerned in this case with the four assessment years, 1945-46, 1946-47, 1947-48 and 1948-49. For these assessment years, applications were made by the two partners Renu Bala Devi and Ratilal Manishankar Dave under Section 26A, Income Tax Act, for registration of the partnership constituted under the first deed dated 15-9-1944. The Income-tax Officer rejected these applications on the ground that the names of all the seven partners were not mentioned in the applications. The Income-tax Officer took the view that the partnership deed of 15-9-1944 did not correctly represent the persons who were the partners of the firm, or the correct shares held by the partners. The assessee firm preferred an appeal to the Appellate Assistant Commissioner, who allowed the appeal and ordered that the firm should be registered for all the years in question. The Appellate Assistant Commissioner considered that the second: partnership agreement of 23-11-1945 did not affect the first partnership constituted on 15-9-1944 between Renu Bala Devi and Ratilal Manishanker Dave. The Income-tax Department appealed to the Appellate Tribunal against the order of the Appellate Assistant Commissioner, and the ground of appeal was that the deed of partnership dated 15-9-1944 did not give a correct picture of the manner in which the profits of the business were actually shared. The appeal was dismissed by

the Appellate Tribunal who affirmed the order of the Appellate Assistant Commissioner on the ground that there was nothing to show that Renu Bala Devi was a party to the second deed of partnership, or that she had knowledge thereof.

2. In these circumstances, the Income-tax Appellate Tribunal has referred the following question of the law for the determination of the High Court:

"Whether in the circumstances, the assessee firm constituted under the deed of partnership dated 15-9-1944, was registerable under Section 26A, Indian Income-tax Act, in the assessment year 1945-46, 1946-47, 1947-48 and 1948-49 respectively?"

3. On behalf of the Income-tax Department, Mr. R.J. Bahadur put forward the argument that the second deed of partnership was retrospective in effect and one of the clauses of that partnership deed was that the six partners would be entitled to a share of the assets and also of the profits with retrospective effect from the 15-9-1944. The argument of learned Counsel was that the second deed of partnership must be read as a part and parcel of the first partnership deed, and, therefore, the application for registration made by the assessee did not give a correct picture of the manner in which the profits of the partnership were actually shared. In my opinion, the contention advanced by the learned Standing Counsel is not valid. It is the admitted position that Renu Bala Devi was not a party to the second document of partnership which was entered into between Ratilal Manishankar Dave and the other five persons. There is no privity of contract between Renu Bala Devi and the five persons who entered into the second deed of partnership with Ratilal Manishanker Dave. It is clear therefore, that the first partnership constituted between Srimati Renu Bala Devi and Ratilal Manishanker Dave was not affected in any manner by the constitution of the second partnership under the document of 23-11-1945. Reference should be made in this connection to Section 2(6B), Income-tax Act, which enacts that the expressions "firm", "partner" and "partnership" have the same meaning in the Indian Income-tax Act as in the Indian Partnership Act, 1932 "provided that the expression 'partner' includes any person who being a minor has been admitted to the benefits of partnership". Therefore, the legal conception of partnership in the Income-tax law is essentially the same as in the Indian Partnership Act. Now Section 5, Indian Partnership Act provides that the relation of partnership arises from contract and not from status. It follows that there can be no partnership in the eye of law unless there is privity of contract between the parties. The position is made still more clear by the term of Section 29(1), Partnership Act. Section 29(1) states:

"A transfer by a partner of his interest in the firm, either absolute or by mortgage, or by the creation by him of a charge on such interest, does not entitle the transferee, during the continuance of the firm, to interfere in the conduct of the business, or to require accounts, or to inspect the books of the firm, but entitles the transferee only to receive the share of profits of the transferring partner, and the transferee shall accept the account of profits agreed to by the partners."

Section 31(1) is also important. It says:

"Subject to contract between the partners and to the provisions of Section 30, no person

shall be introduced as a partner into a firm without the consent of all the existing partners."

4. In view of the statutory provision, it is clear that the five persons who entered into the second contract of partnership with Ratilal Manishanker Dave could not be held to be partners of Srimati Renu Bala Devi under the first contract of partnership. The result of the second contract was to constitute what is called a sub-partnership between Ratilal Manishanker Dave and the five other persons. But this document would in no way affect the first contract of partnership executed on 15-9-1944. The legal position has been explained very well at page 69 of Lindley's Law of Partnership, eleventh edition:

"A sub-partnership is as it were a partnership within a partnership; it presupposes the existence of a partnership to which it is itself subordinate. An agreement to share profits only constitute a partnership between the parties to the agreement if, therefore, several persons are partners and one of them agrees to share the profits derived by him with a stranger, this agreement does not make the stranger a partner in the original firm. The result of such an agreement is to constitute what is called a sub-partnership, that is to say it makes the parties to it partners inter se; but it in no way affects the other members of the principal firm. In the language of civilians, Socius mei socii, socius meus non est."

5. In - 'Ex parte, Barrow', (1815) 2 Rose 252, Lord Eldon has explained the law on the point in a very clear manner:

"I take it to have been long since established, that a man may become a partner with A where A and B are partners and yet not be a member of that partnership which existed between A and B. In the case of Sir Chas. Raymond, a banker in the city, a Mr. Fletcher agreed with Sir Chas. Raymond that he should be interested so far as to receive a share of his profits of the business, and which share he had a right to draw out from the firm of Raymond and Co. But it was held that he was no partner in the partnership; had no demand against it; had no account in it; and that he must be satisfied with a share of the profits arising and given to Sir Chas. Raymond."

6. This view is further borne out by a decision of the Calcutta High Court in - '*Commissioner of Income Tax, Central, Calcutta v. Messrs. Dudwala and Co!*.'. In that case a partnership was constituted of the manager of a joint Hindu family representing the family and a stranger. A suit for the partition of the family was instituted by one of the members of the family which resulted in a compromise. The consent decree passed provided that each of the members of the joint family should have a certain share and further stated that the parties had twelve annas share in the partnership firm and each of the members were entitled to the share of the partnership also according to the shares mentioned in the decree. An application under Section 26A, Income-tax Act, was refused by the Income-tax Officer on the ground that as the joint family had come to an end it could not form a partnership with a stranger unless and until the separate members of the family along with the stranger formed themselves into a partnership and applied for registration. It was held by the Calcutta High Court upon these facts that the disruption of the joint family had

no effect at all on the constitution of the firm or the manager's status as a partner of the firm and that the partnership firm should be registered under Section 26A, Income-tax Act.

7. Counsel on behalf of the Income-tax Department relied upon - '*P.A. Raju Chettiar and Bros. v. Commissioner of Income Tax, Madras*<sup>2</sup>', In that case two brothers A and B constituted a Hindu undivided family and carried on a business. B died leaving behind him a widow and two minor sons. In August, 1940 there was partition in the family and partnership was entered into between A and the two minor sons of B, the minors being represented by their mother. Subsequently, it was realised that there could be no valid partnership between an adult and two minors, and in August, 1941 a fresh partnership deed was entered into between A and the widow of B. It was held by the Income-tax authorities that the partnership could not be registered under Section 26A for the reason that there was no genuine partnership between A and the widow, and the share shown as belonging to the widow, did not belong to her but to the two minor sons. It was held by the Madras High Court that registration under Section 26A was rightly refused, because there was no genuine partnership between A and the widow of B but it was only a simulate arrangement. The principle of that case has no application to the present case, for the finding of the Income-tax Appellate Tribunal is that the partnership deed constituted between Srimati Renu Bala Devi and Ratilal Manishankar Dave on 15-9-1944, is a genuine transaction.

8. Mr. Bahadur also referred to - '*M. Kanniappa Naicker and Co. v. Commissioner of Income Tax, Madras*<sup>3</sup>', The ratio of the case is also of no assistance to the Income-tax Department. In that case a partnership was constituted of a firm called M.K.N. and Sons and two other persons R and G for carrying on certain business in the Madras Port Trust. The new firm was called M. K.N. and Company and it applied to the Income-tax authorities for registration under Section 26A, Income-tax Act. The application mentioned the proportion to which the profits and loss were to be shared between M.K.N. and Sons and the other partners R. and G. But the application did not specify the shares of the partners of the smaller firm of M.K.N. and Sons. The Income-tax authorities refused to register the firm of M.K.N. and Co. and it was held by the Madras High Court that the action of the Income-tax authorities was justified. The legal principle underlying this case is that a firm as such cannot enter into a partnership with other persons. The reason is that in the eye of law a firm is not a legal entity but it is a mere collective name for individuals constituting the firm. It is, therefore, clear that the individuals constituting the smaller firm of M.K.N. and Sons were in the eye of law the partners of the larger firm of M.K.N. and Co., and, therefore in the application for registration under Section 26A the names and the shares of the individual partners of the smaller firm M.K.N. and Sons ought to have been specified. Since the assessee had omitted to specify these particulars, the

requirements of Section 26A were not fulfilled and the Income-tax authorities were justified in refusing registration to the firm of M.K.N. and Co. That is ratio decidendi of this case, but it has no application to the material facts of the present case.

9. For the reasons I have already expressed, I hold that in the circumstances of this case the assessee firm constituted under the deed of partnership dated 15-9-1944 was registerable under Section 26A of the Income-tax Act for assessment years 1945-46, 1946-47, 1947-48 and 1948-49. I would accordingly answer the question referred to the High Court in favour of the assessee and against Income-tax Department. The assessee is entitled to the costs of this reference, hearing fee Rs.250/-.

**Banerji, J.**

10. I agree.

Answered in the affirmative.

Cases Referred.

<sup>1</sup> AIR 1950 Cal 315

<sup>2</sup> AIR 1949 Mad 516

<sup>3</sup> AIR 1937 Mad 316 (SB)