

# PUNJAB AND HARYANA HIGH COURT

Kalsi Mechanical Works

Vs

Commr. of Income-Tax

(Falshaw, C.J. Kapur, J.)

01.07.1953

## JUDGMENT

### **Kapur, J.**

1. This is a reference made by the Income-tax Appellate Tribunal, Delhi Bench, by their order dated 17-2-1953, referring to this Court for opinion the following question:

"Whether a firm which is alleged to have come into existence by a verbal agreement in June 1944 is entitled to be registered under Section 26A for the purpose of the assessment for 1949-50, where the Instrument of Partnership was drawn up only in May, 1949, after the expiry of the relevant previous year?"

2. The case relates to the accounting year 1948-49 and assessment year 1949-50. The assessee firm alleges that it was brought into existence in June 1944 with three persons as partners between whom there was no written deed of partnership drawn up. On 9-5-1949, a written deed of partnership was executed between the partners which is printed at page 4 of the paper-book. This instrument of partnership recites that two partners, Nauhria Singh and Ram Singh, started it in the year 1912 and in 1938 another partner Chanan Singh was taken into partnership and on the death of Ram Singh, Gurdial Singh his son became a partner; the shares of the partners remaining the same, only Gurdial Singh took the place of Ram Singh.

This partnership deed provides :

".....The parties.....mutually covenant and agree to continue as partners in the said business upon and subject to the terms and conditions stated below.....

3. That the partnership business shall be deemed to have commenced in the present constitution on 23-6-44.

7. That a statement of assets and liabilities of the partnership business as ending on 31-3-49 has been drawn up and the credits to the capital accounts of the parties hereto are accepted and

confirmed.

11. That the parties hereof will be entitled to the following salaries with effect from 1-4-49 which will be debitable to the Profit & Loss account of the partnership business:

1. S. Nauhria Singh. Rs. 300/- p.m.
2. S. Gurdial Singh. Rs. 200/- p.m.
3. S. Chanan Singh. Rs. 250/- p.m. ... .."

This document was registered before the Joint Sub-Registrar on 26-8-1949.

3. During the assessment year 1949-50, the firm applied to the Income-tax Officer for registration of the firm under Section 26A, Income-tax Act, for the purpose of assessment of the accounting year 1949-50. This was rejected by the Income-tax Officer and ultimately by the Income-tax Appellate Tribunal who held that as the partnership had come into existence by an oral agreement in June 1944 and the instrument of partnership was not executed till May 1949, i.e. after the year of the account relevant for the assessment year 1949-50, the assessee firm was not entitled to get the registration effected under Section 26A, Income-tax Act.

4. The learned Advocate for the assessee submitted that under Section 26A read with the rules he was entitled to get the registration done even though the instrument of partnership had come into existence during the assessment year. Section 26 provides : (His Lordship quoted the provision and stated). Mr. Jagdish, Chandar relied strongly on the rules which have been made under Section 59, Income-tax Act. By Rule. 2 any firm constituted under an 'instrument of partnership..... may, under the provisions of Section 26A of the Act register with the Income-tax Officer..... in the said instrument..... Such an application has to be signed by all the partners and has to be made 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 and if the application is made after the dissolution it has to be signed by all the persons or their legal representatives who were partners in the firm. Under Rule 3 the application has to be accompanied by the original instrument of partnership under which the firm is constituted".....

Rule 4 prescribes the powers of the Income-tax Officer in regard to registration. It says:

"4. (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 writirig at the foot of the instrument or certified copy, as the case may be, a certificate in the following form, namely : This 'instrument of partnership' (certified copy of an instrument of partnership) has this day been registered with me, the Income-tax Officer for..... in the Province of..... under Section 26A, Income-tax Act, 1922, and this certificate of registration shall have effect for the assessment for the year ending on the 31st day of March 19.' Again in Rule 6A it is stated:

"6A. On receipt oi an application under Rule 6 and the Income-tax Officer may, if he is satisfied that the application is in order and that there is or was a firm in existence constituted as shown in the instrument of partnership....."

5. It is to be noted that Rule 2 (e) mentions the words 'in respect of the assessment or assessments to be made on its income up to the date of dissolution.' It presupposes that the instrument of partnership was in existence during the period ending the date up to which the assessment is to be made. In Rule 4, the words used are 'is or was a firm in existence.' Similarly in Rule 6-A the words used are 'that there is or was a firm.'

6. There are no words used in Section 26A which would indicate that this section is meant to be retrospective or that a firm constituted by an instrument of partnership after the last day of the accounting period can be registered for the purpose of affecting the income-tax of that period. This is supported by the language used in Sections 26 and 28 of the Income-tax Act. Section 26 shows that the object of registration is to assess individually the total income of the partners who in the account year were entitled to receive the same and there would be no point in producing an instrument for registration during the assessment year. In Sampath Iyengar on Indian Income-tax Act Vol. 2 at page 846 a very good discussion on this point has been given. The instance given there is in my opinion quite apt. If there were two partners A and B sharing equally the profits say up to the 31-3-1950 and thereafter the share of profits was 3 to 1 and the income for 1949-50 or for the year 1950-51 was Rs. 50,000/-. A deed of partnership registered for the former accounting period would show the income of each to be Rs. 25,000/- and an instrument registered for the next accounting period would show the income to be Rs. 37,500/- and Rs. 12,500/- respectively and these last figures would be useless for the purpose of assessment proceedings for the year 1950-51.

7. Again a reference to Section 28 (2) which relates to the imposition of penalties makes this matter clearer. This section mentions the registration of an instrument of partnership governing the distribution of profits which shows clearly that the instrument which has to be registered is the one relating to the accounting period. The matter has been put by Sampath Iyengar at p. 846 in the following words:

"The language of sub-section (2) of section 28 relating to the levy of penalty makes the matter yet clearer. It speaks of registration of the instrument of partnership governing the distribution, which unmistakably indicates that the deed that has to be registered is the deed relating to the accounting year. The new Clause (e) to Rule 2 with its proviso, along with the corresponding amendment made in Rules 3 to 6 refer to the registration of a firm after dissolution at the instance of the ex-partners or the legal representatives of any deceased partner. This shows that there need be no firm in existence at the time of the application for registration. Rules and 6A also enable registration of a firm that "is or was" in existence. If it is registration of a firm that was in existence, the deed to be registered could only be that of the previous year and not the assessment year. All these considerations point to the conclusion that though a change has occurred in the constitution of the firm, the deed that has to be registered is the deed governing the

distribution of the accounting year."

In my opinion, the law has been correctly stated by this author.

8. If reference is made to form I under Rule 3 of the Rules it shows that application is to be made for the assessment for the income-tax year and in the third paragraph of this form the partners have to certify :

"We do hereby certify that the profits (or loss, if any) previous year were period upto date of dissolution were/will be or credited as shown in Section B of the schedule and that the information given above and in the attached schedule is correct."

All this indicates that the registration to be applied for is of a firm which had been constituted by an instrument of partnership previous to the assessment year & not that it should come into existence during the year of assessment which under the Indian law is always the year following the year in which the income has accrued.

9. The words used in Section 26A are "any firm constituted under an instrument of partnership." 'The Queen v. The Registrar of Joint Stock Companies', (1891) 2 Q. B. 598 (A), is of some assistance in this connection where it was held at a partnership formed not for carrying on business but simply for the purpose of being incorporated under the Companies Act, in order that it may be forthwith wound up, can-not be registered as a company under Part VII the Companies Act of 1862. At page 612 Fry J. said:

"I am inclined to think that the true meaning, of these words is confined to a company which is constituted in some manner analogous to those with which this section begins, namely, constituted by registration under some Act of Parliament, or in pursuance of an Act of Parliament, or under Letters Patent. I am inclined to think it must be some constitution ejusdem generis with those--that those words refer to cases in which the constitution of the company does not arise merely from the consensual agreement of the parties, but in which that constitution is either determined or modified, or affected in some way by something other than mere consent--by something which the law imposes -- something, I say, like an, Act of Parliament or letters patent....."

Lopes L. J. was of the same opinion and said "at page 614-

'I am inclined to think that the true meaning of those words is this, that they refer to companies constituted by the intervention of the legislature or other tribunal competent to constitute companies, and do not refer to consensual contracts such as the present."

10. The learned Advocate-General has relied on three cases in support of his argument. submits that the assesseees were not constituted under an instrument of partnership in the account year and therefore they are not

entitled to registration under Section 26A. He refers to a passage from Lindley on Partnership eleventh edition at p. 116, where it is stated:

'Again, persons may agree that as between themselves, the partnership between them shall be deemed to have commenced at some time before its actual commencement. Proof of such an agreement as this would not enable a stranger to make the parties to it liable to him as partners for what took place before the partnership in point of fact began. As for third parties, such an agreement is 'res inter alios acta', which does not affect them in any way ....."

This statement of the law shows that strangers are not affected by an agreement between the partners where the partnership is deemed to have commenced at a date before the date of its commencement.

11. Reference was then made to -- '*Commr. of Income Tax v. Krishna Aiyer*'<sup>1</sup>, In this case the partners of a firm constituted in August 1923 under a partnership deed for a term of three years continued the partnership after the expiry of that term but without a fresh deed of agreement. For the assessment year 1927-28. a return of the previous year was submitted together with an application for registration of the firm under Section 2(14)', Income-tax 'Act, which was refused and it was held that the contractual nexus between the partners after the expiry of the original term being a new implied oral agreement, there was no instrument of partnership operative at the time of the application which could be registered under Rule 2, Registration Rules.

Coutts-Trotter C. J. referred to a speech of. -- '*Westbury L. C. in Clarke v. Leach*'<sup>2</sup>, (where the Lord Chancellor said:

"Ordinarily, a contract for a term constituted, by a written agreement must be considered as having come to an end at the expiration of the period for which it was entered into; and the contract during the term differs from that which arises from the continuance of the relation by the mutual consensus of the parties after the term has expired. The one is to last for a certain term; the other only for so long a time as they both shall choose. Am I then by any principle of law bound to assume or justified in assuming that all the special articles and conditions in the original written deed of partnership for a term are at once transferred by law to this new contract, which has no particular limit to the term of its duration? That would be a strong and extravagant assumption and one that is not warranted by any principle or authority."

The learned Chief Justice then observed:

"That passage appears to me to make it clear that Lord Westbury considered the

contractual 'nexus' of the parties after the expiry of the deed to rest upon the new implied oral agreement, and that the articles of the deed which are to be considered as preserved are preserved not by virtue of the original deed which had ceased to operate but of the new agreement."

He then referred to the speech of Lord Selborne in -- 'Neilson v. Mossend Iron Co.', (1886) 11 AC 298 (D)', and observed:

"These pronouncements of the highest tribunal do not turn on any special provision of any statute but are based on the general principles of the law of partnership and we should, we think, endeavour respectfully to follow those high authorities."

12. Reference was next made to -- '*Commissioner of Income-tax, Madras, v. Gelli Krishnamurthy*<sup>3</sup>', where the facts were similar in that a partnership deed which was for a term of five years was not renewed by a fresh instrument but the business was carried on and during the assessment year 1987-38 she assesses applied for the renewal of the certificate. It was held that the partnership deed not having been renewed by a written instrument, there was no 'instrument of partnership within the meaning of Rule 2 Income-tax Rules. –

13. In a later case. -- '*Commissioner of Income-tax, Madras v. D. Arokiaswami Chetti & Co.*', AIR 1949 Mad 221 (F), it was held that for a registration of a firm under Section 26. A Income-tax Act, the existence of an instrument of partnership operative at the time of the application or relevant to the accounting period is necessary. At page 222 Rajamannar C.J. observed-

"We do not agree with the view of the Tribunal that for a renewal of registration there is no necessity for the existence of an instrument of partnership operative at the time of the application or relating to the accounting period. Section 26A does not refer in terms to renewal of registration. It follows that every renewal of registration is in effect a registration under that section."

14. The sections of the Income-tax Act show that for the purpose of registration, it is necessary, that the firm should be constituted by an instrument of partnership and in my opinion the Rules read with Ss. 26 and 28 of the Act indicate that such a firm as is constituted under an instrument, of partnership should have been in existence during the account period and should not come into existence during the assessment year, and if it was not in existence during the account period it cannot be registered so as to affect the liabilities of the partners of income-tax accruing during the account period. I would therefore answer the question referred to us in the negative. The Commissioner of Income-tax will have his costs. Counsel's fee Rs. 250/-

**Falshaw, J.**

15. I agree.

#### Cases Referred.

1AIR 1929 Mad 67 (B)  
21863). 1 De. G. J. & Section 409 (C)  
3(1940) 8 ITR 121 (E)