

PUNJAB AND HARYANA HIGH COURT

Pran Nath

Vs

Commissioner of Income-Tax

(Bishan Narain, J.)

23.02.1960

JUDGMENT

Bishan Narain, J.

1. These references under section 66 (1) of the Indian Income-tax Act, 1922, by the Appellate Tribunal arise in these circumstances. Pran Nath and Vishwa Nath are real brothers and constitute a Hindu undivided family. This family owns property and earns income therefrom. The two brothers also carry on business in the name of Jagan Nath and Sons. For the assessment year 1946-47, the Hindu undivided family as such filed returns of its income under section 22 of the Income-tax Act. Separate returns were also filed for the firm Jagan Nath and sons and therein an application was made under section 26A of the Income-tax Act for its registration. The two brothers also filed separate returns as individuals. The Income-tax Officer rejected the application under section 26A and held the firm to be Hindu undivided family firm. He assessed the two brothers as members of the Hindu undivided family. He held, by order dated February 28, 1951, that the two brothers had no personal income during the assessment year 1946-47 and so filed their individual cases. The Hindu undivided family appealed against the order on the ground that the profits of the firm were wrongly included in the income of the Hindu undivided family. The firm appealed that its registration under section 26A of the Income-tax Act was erroneously rejected. The two brothers as individuals naturally did not appeal against the order dated February 28, 1951, as no tax was demanded from them. The Appellate Assistant Commissioner accepted the appeal of the firm and directed the Income-tax Officer to register the firm and take assessment proceedings against the firm. This order was made on January 7, 1952. The appeal of the Hindu undivided family was also accepted and the income of the firm was excluded from its assessment. The Income-tax Officer then registered the firm and computed its taxable income by order dated March 21, 1952. He then proceeded under section 23(5) of the Income-tax Act and by two separate orders dated March 24, 1952, the income of each partner of the firm was assessed. In these orders he also directed the demand notices and challans to be issued to Pran Nath and Vishwa Nath individually. Dissatisfied with the two orders, the two brothers separately appealed on the ground that the assessment made on March 24, 1952, was barred by time. The

firm appealed on the ground that the amount computed was excessive. The Appellate Assistant Commissioner decided all these three appeals on March 17, 1953. The brothers appeals were dismissed on the finding that under the second proviso to section 34(3) of the Income-tax Act the assessment was within time. The firms appeal was accepted reducing the amount of the taxable income. A direction was given in the firms appeal that the assessment of the partners is also to be accordingly modified. The brothers and the firm separately filed further appeals to the Appellate Tribunal on the ground that the assessment on the appellants was made after the expiry of limitation. The Appellate Tribunal consolidated the appeals and relying on the second proviso to section 34(3) and on the provisions of section 23(5) of the Income-tax Act dismissed them all. Thereupon Pran Nath and Vishwa Nath separately applied under section 66(1) of the Income-tax Act and the Appellate Tribunal has referred the following questions to this court :

"(1) Whether the assessments for the year 1946-47, made on the applicants on March 24, 1952, without taking action under section 34, were in order ?

(2) Whether these assessments, made as they were on March 24, 1952, are hit as being out of time ?"

I proceed to deal with the first question. The assessee's case is that the orders dated March 24, 1953, by which the brothers' liability as individuals to pay tax on a certain amount of income amount to fresh assessment of escaped income as previously their individual returns had been decided on merits on February 28, 1951. It is, therefore, urged that proceedings to fix the assessee's liability could not be taken without complying with the provisions of section 34 of the Income-tax Act. On the other hand, the case of the Income-tax Department is that the assessment was made under section 23(5) of the Income-tax Act and it amounted to realising tax imposed on the firm through its partners. It was further argued that section 34 can have no applicability to an assessment under section 23(5) of the Income-tax Act. It is now settled law that notion of general law of partnership that a firm is only a short and collective name for its partners has no application to the law of income-tax. Under the law of income-tax a firm is a distinct assessable entity and its partners are individually separate assessable entities. It has been so held by the Supreme Court in *Commissioner of Income-tax v. A.W. Figgies and Company*. It follows that separate and independent proceedings must be taken to compute the taxable income of a firm and of its partners. The taxable income of the firm is to be determined under sub-section (1), (3) or (4), as the case may be, of section 23 of the Income-tax Act. The taxable income of the partners as individuals is also to be computed under the same provisions. The procedure for levying tax on the earnings of a firm registered under the Income-tax Act and of a firm not so registered is not identical. In the present case we are concerned only with the registered firm and the procedure applicable to these firms only need to be described. After the taxable income of a registered firm has been ascertained, the procedure laid down in section 23(5)(a) of the Income-tax Act is to be followed. Under this provision the amount of tax payable by the firm is not to be determined but instead the share of the income of each partner is to be fixed. No levy of income-tax is made on registered firm itself. The share of a firm's taxable income of each partner is then taken to his assessment proceedings as an individual because in reality the individual partner is the assessee and it is he who is liable to pay the tax. His share of firm's taxable income is added to the partner's other income as an individual and the amount of tax to be levied on him as an individual is then assessed and is demanded from him. Thus the partners of a registered firm are

liable to be charged in their individual assessments to income-tax in respite of their share of the firms profits or taxable income. If, however, there is a loss in the registered firm the partner in his individual assessment is entitled to set it off against his other income as an individual or get it carried forward and set off in accordance with the provisions of section 24 of the Income-tax Act (vide first proviso to section 23(5)(a) and section 16(1)(b)). It is also open to a partner in his individual assessment to claim a deduction from his wholly or exclusively for earning his share of profits (vide *Shantikumar Narottam Morarji v. Commissioner of Income-tax and Mool Chand v. Commissioner of Income-tax*). It, therefore, follows that income-tax on partner of registered firm is levied after his individual income from his property and other sources, including his share in the firms profits, has been computed and after the rate payable by an individual assessee on such a total income has been determined. As I have already said, in such a case the real assessee for payment of tax is the individual partner and not the firm. That being so, it must be held that the contention raised on behalf of the Income-tax Department that the real assessee is the registered firm itself and that the individual income of a partner has to be brought to the firms assessment proceedings and the tax payable is to be determined in the assessment file of the firm itself are contrary to the provision of section 23(5) of the Income-tax Act and also are in conflict with the scheme of the Act. This contention raised on behalf of the Department must, therefore, be rejected. In the present case, the Hindu undivided family, the firm, and Pran Nath and Vishwa Nath, as individuals, made separate returns of their income for the assessment year 1946-47. The Income-tax Officer passed orders on all these returns on February 28, 1951. Under these orders, the Income-tax Officer held that Pran Nath and Vishwa Nath, as individuals, had no personal income and filed their cases for the assessment year 1946-47. This was obviously a final order on the returns filed by these assesseees, as individuals. However, later on under orders of the Appellate Assistant Commissioner, he registered the firm, then computed the firms taxable income and divided the amount equally between the two brothers. The Income-tax Officer made this division by order dated March 24, 1952, purporting to act under section 23(1) of the Income-tax Act and levied tax on these brothers as individuals. This levy of tax in my view amounts to a fresh levy of tax after reopening the assessment proceedings of the two brothers when these proceedings had been finally disposed of on February 28, 1951. A final assessment, however, cannot be re-opened or a fresh levy of income-tax cannot be made without complying with the provisions of sections 34 and 35 of the Income-tax Act. In the present case we are concerned with section 34 only as no reliance has been placed by the department on section 35 of the Income-tax Act. In the present case we are concerned with section 34 only as no reliance has been placed by the department on section 35 of the Income-tax Act the earlier proceedings failed to result in levy of tax because the Income-tax Officer was of the opinion that the profits of the firm belonged to the Hindu undivided family and not to the brothers individuals and that its profits could not be added to the brothers individual income. This view was found to be erroneous and in accordance with the view of the Appellate Assistant Commissioner the profits of the firm were divided between its partners and the partners as individuals were called upon to pay income-tax on their share of the income. This was, therefore, obviously a case of a chargeable income escaping assessment and section 34 of the Income-tax Act applied to the case. It is well settled that it is not open to the Income-tax Officer after a final assessment to go on making fresh assessments and issuing fresh notices of demand. Fresh notices can be issued only under sections 34 and 35 of the Income-tax Act which prescribe the circumstances in which fresh notices can be issued or fresh assessments can be made (vide *Commissioner of Income-tax v. Kehmchand Ramdas and Prashar v. Vasantsen Dwarkadas*). In the present case admittedly the provision of section 34 has not been complied with. I am, therefore, of the opinion that the

Income-tax Officer could not make the assessment for 1945-47 on the two brothers, as individuals, on March 24, 1952, without taking action under section 34 of the Income-tax Act and, therefore, the first question referred to this court must be answered in the negative. This brings me to the second question. It relates to limitation. It is common ground between the parties that no assessment could be made in the present case after the expiry of four years and that the limitation under section 34 of the Income-tax Act expired on March 31, 1951. The assessments under consideration was made on March 24, 1952, and was obviously made after the expiry of limitation. The Tribunal relying on second proviso to section 34(3) of the Income-tax Act held the assessment to be within time on the ground that the Act held the assessment to be within time on the ground that the reassessment was made in consequence of or to give effect to the directions given by the Appellate Assistant Commissioner on firms appeal. The second proviso was amended in 1953 by section 18 of the Income-tax (Amendment) Act, 1953, and this amendment was made effective only from April 1, 1952. By this time, the limitation had expired in the present case. Therefore, the second proviso as amended has no application to the present case (vide *Sardar Lakhmir Singh v. Commissioner of Income-tax*). The learned counsel appearing for the department in fact conceded that the second proviso as amended in 1953 has no application to the present case. It was also admitted, and in my view quite rightly, that the limitation is not extended in the present case by the second proviso as it stood prior to its amendment in 1953. For these reasons, the answer to the second question must be in the affirmative. The result is that the first question is answered in the negative and the second in the affirmative. The assesseees are entitled to get their costs from the Department. Counsels fee in each case Rs. 250.

Dua, J. - I Agree.

Reference answered accordingly.