Shanker Tobacco Stores Vs Commissioner of Income Tax

Court: Calcutta High Court

Date of Decision: April 17, 1969

Acts Referred: Income Tax Act, 1922 â€" Section 26A

Citation: (1970) 77 ITR 884

Hon'ble Judges: Sabyasachi Mukharji, J; Deb, J

Bench: Division Bench

Advocate: A.K. Mazumdar, for the Appellant; Biswarup Gupta and Ajoy Mitra, for the Respondent

Judgement

Sabyasachi Mukharji, J.
This reference was heard by us on the 4th February, 1969, None appeared for the applicant on that occasion.

After hearing the counsel for the revenue we delivered judgment on that day. Thereafter, the matter was mentioned before us by the learned

counsel appearing for the assessee and it was prayed that as through inadvertence the counsel could not appear on that date he should be given an

opportunity to make his submissions. We gave him such opportunity and this judgment is being delivered in supersession of the judgment we

delivered on the 4th February, 1969.

2. This was a reference u/s 66(2) of the Indian Income Tax Act for the determination of the following question:

Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the registration u/s 26A of the Indian Income Tax

Act could not be granted to the firm ?

3. The application for registration of the firm u/s 26A of the Indian Income Tax Act was refused by the Income Tax Officer. On appeal, the

Appellate Assistant Commissioner held that the assessee-firm was not entitled to registration. There was a further appeal before the Tribunal. The

Tribunal after going through the facts of this case observed that there was a specific provision in the instant case that the partners would have to

introduce capital in proportion to their profit sharing ratio, but the deed of partnership did not specify as to what would be the capital of the firm.

The deed of partnership, on the basis of which registration was sought, the Tribunal was of the opinion, was vague. The Tribunal further held that

the contribution by the partners in the form of capital could also not be determined with any degree of certainty. The Tribunal was of the opinion

that it was not possible to determine what would be the amount introduced by the partners on which interest had to be charged and debited to the

profit and loss account. Therefore, the Tribunal held that the profit as well as the distribution thereof among the partners was uncertain and vague.

From those facts the Tribunal came to the conclusion that the firm was not entitled to registration u/s 26A of the Indian Income Tax Act, 1922.

4. The question that requires consideration in the instant reference is whether the Tribunal was justified in upholding the decision of the Income Tax

authorities. In the order of the Tribunal the Tribunal has referred to the fact that the Income Tax authorities had observed that the amount

introduced in the books of the firm in the names of the partners were not in their profit sharing ratio and during the accounting period in 1960-61,

no account was earmarked as capital, and interest was charged on the entire balance standing to the credit of the respective partners and that no

interest was charged during the accounting period for 1959-60. Registration was refused by the Income Tax authorities on the ground that the

terms of the instrument had not been given effect to by the partners. It was contended by the learned counsel for the assessee before the Tribunal

that inasmuch as the Income Tax authorities had not doubted the genuineness of the firm the fact that there was a slight variation in the proportion

of the capital introduced by the partners from their profit sharing ratio, did not invalidate the partnership. It was further contended that the fact that

no interest had been charged in the second year on the capital introduced could not be considered against the assessee as the same was mutually

agreed to amongst the partners themselves. It was further urged that introduction of capital was not a sine qua non for the constitution of a

partnership. The Tribunal on a consideration of the terms of the deed of partnership came to the conclusion that the partnership deed was vague

and the computation of the profit as well as distribution thereof among the partners would be completely vitiated in view of this vagueness. They

therefore upheld the orders as mentioned hereinbefore.

5. In the case of P.R. Chowdhary and S. Gangoli Vs. The State of U.P., . the Supreme Court has observed :

The following essential conditions must be fulfilled in order that a firm may be held entitled to registration :

(1) That the firm should be constituted under an instrument of partnership, specifying the individual shares of the partners.

(2) That an application on behalf of, and signed by, all the partners, containing all the particulars as set out in the Rules, had been made ;

(3) That the application has been made before the assessment of the income of the firm, made u/s 23 of the Act (omitting the words not necessary

for our present purpose), for that particular year;

(4) That the profits (or loss, if any) of the business relating to the previous year, that is to say, the relevant accounting year, should have been

divided or credited, as the case may be, in accordance with the terms of the instrument; and, lastly,

(5) That the partnership must have been genuine, and must actually have existed in conformity with the terms and conditions of the instrument.

6. At page 204 the Supreme Court observed :

As a result of the above discussion, the conclusion is reasonably clear that unless the partnership business was carried on in accordance with the

terms of an instrument of partnership which was operative during the accounting year, it cannot be registered in respect of the following assessment

year.

7. With these principles in the background we have to examine the present deed of partnership. Clause 4 of the partnership deed provides :

4. The share of each partner in the net profit and loss of the partnership business after deducting usual business expenses shall be as follows:

1. Shri Bhawarlal Rathi ... As. 0-7-0 (seven) in the rupee.

2. Sri Sitarara Rathi ... As. 0-3-0 (three) in the rupee.

3. Sri Jormal Rathi ... As. 0-3-0 (three) in the rupee.

8. Thereafter Clause 6 is in the following terms :

6. The capital of the firm shall be contributed by the partners in their profit sharing ratio. Any amount in excess of the share capital standing to the

credit of any partner at any time shall bear interest @ 6 per cent. per annum, and such interest shall be debited to the profit and loss account of the

firm.

9. It is manifest, therefore, that a contribution of the capital of the firm is necessary by the partners by the express terms of this partnership deed. It

is also necessary to remember that interest would be payable in excess of the proportion of the capital contributed. After the payment of interest

the net profit and loss would have to be determined. The deed, however, does not specify what would be the capital of the firm. It will therefore be

not possible to determine what would be the interest that will be payable on the excess. Unless this is determined it would not be possible to

determine what would be the amount of profit and loss and, as such, specification of the individual shares of profit and loss of the partners cannot

be made from the deed itself. The learned editors of Lindley on Partnership, eleventh edition, at page 504, state :

The proportions in which the capital is to be contributed by the partners and the proportion in which they are to be entitled to it when contributed,

ought also to be carefully expressed.

10. Learned counsel for the assesses drew our attention to the decision of the Patna High Court in the case of M/S. SAHABUDDIN

MOHAMMAD RAZA (SIWAN) Vs. COMMISSIONER OF Income Tax, BIHAR and ORISSA., . In that case there was no separate capital

account of the partners and share capital was contributed by some of the partners originally. It was held that that was no ground for refusing

registration of the firm. In our opinion, that case does not help the assessee in the facts of the instant reference. It does not appear that there was

any provision like Clause 6 of the present case. In that case also the non- contribution of capital did not lead to the non-specification of share of

profit and loss of the partners as it does in the instant case. Reliance was also placed by the learned counsel for the assessee on the decision of the

Bombay High Court in the case of S.C. Prashar, Income Tax Officer, Market Ward, Bombay and Another Vs. Vasantsen Dwarkadas and

Others, . There the court held that the determination of profits by a firm in a manner different from the provisions of the Indian Income Tax Act, or

even not strictly in accordance with the express terms of the deed of partnership, would not entitle the Income Tax Officer to reject the application

for registration of the deed of partnership u/s 26A of the Indian Income Tax Act, 1922, on the ground that the application for registration had not

been properly made within the meaning of Rule 4 of the Indian Income Tax Rules, 1922. It is true that in the instant case the Income Tax

authorities had observed that the amount introduced in the books of the firm in the name of the different partners were not in the profit sharing ratio,

yet the Tribunal had really refused registration not on that ground but on the ground that the partnership deed, suffered from vagueness and did not

specify the individual share of profit and loss of the partners. Therefore, the decision of the Bombay High Court, in our opinion, could not be

availed of by the assessee in the instant case. We may, however, observe that before the Bombay High Court, it appears, the decision of the

Supreme Court in the case of R. C. Mitter & Sons v. Commissioner of Income Tax, specially the observation of the Supreme Court at page 204

of the judgment, as mentioned hereinbefore, was not cited. Reliance was also placed by the learned counsel for the assessee on the decision of the

Madhya Pradesh High Court in the case of COMMISSIONER OF Income Tax, MADHYA PRADESH, NAGPUR AND BHANDARA Vs.

MADANLAL CHHAGANLAL., . There the court held that the firm was entitled to registration u/s 26A of the Indian Income Tax Act, 1922, on

the basis of their application, notwithstanding that subsequent to the date of application, in making a division of the profits, the partners failed to

credit interest for their respective capital investment. The court observed at page 479 :

The mere fact that the partners did not adhere to the term relating to payment of interest as provided in that instrument can be no ground for

refusing to register the firm.

11. Here also we may mention, as it appears from the judgment, that the attention of the court was not drawn to the observation of the Supreme

Court in the case of R. C. Mitter & Sons v. Commissioner of Income Tax, referred to hereinbefore. In the instant case the Tribunal has not refused

registration on the ground of the failure of the assessee to adhere to the terms of the partnership deed. The Tribunal in the instant case has upheld

refusal of the registration on the ground that the partnership deed was vague. In that view of the matter we are of the opinion that this decision is

also of no assistance to the assessee in the present reference.

12. For the reasons mentioned hereinbefore, we are of the opinion that the Tribunal was right in holding that the registration u/s 26A of the Indian

Income Tax Act, 1922, could not be granted to the firm. The answer to the question referred to this court is, therefore, in the affirmative. The

revenue is entitled to the costs of this reference including S.C.R. 641 (S.C.). the costs of the 1st date of hearing, 4th of February, 1969, and the

subsequent date of hearing.

Deb, J.

13. I agree.