MOTICHAND AND DEVIDAS IN RE.

Court: Bombay High Court

Date of Decision: Sept. 6, 1944

Acts Referred: Income Tax Act, 1961 â€" Section 66(1)

Citation: (1946) 14 ITR 534

Hon'ble Judges: Kania, Acting C.J.

Bench: Division Bench

Judgement

KANIA, Ag., C.J. - This is a reference made by the tribunal of Appeal u/s 66(1) of the Indian Income Tax Act, in respect of the assessment of

Messrs. Motichand and Devidas, Solicitors, for the accounting year 1939. The relevant facts are these.

The firm of Messrs. Motichand and Devidas was carrying on business, as attorneys of this Court, since 26th January, 1909. The first partnership

deed, referred to in this reference, was dated 29th October, 1926, and was executed between Mr. Motichand G. Kapadia and Mr. Devidas J.

Desai, they sharing the profits and loss equally. A fresh partnership deed dated 15th July, 1936, was executed when Mr. Tanubhai, son of Mr.

Devidas, was admitted as a partner. The shares of the partners were then readjusted, Mr. Motichand got seven annas, Mr. Devidas got seven

annas and Mr. Tanubhai got two annas. The shares of the partners were subsequently changed to seven annas, five annas and four annas

respectively, according to the writing dated 20th November, 1937. Mr. Devidas died on 8th July, 1940, with the result that on that day the firm

was dissolved. A notice dated 11th September, 1940, was published in the government Gazette and other newspapers notifying the dissolution of

the firm on 8th July, 1940. A fresh partnership agreement was entered into on 12th September, 1940, between Mr. Motichand and Mr. Tanubhai,

sharing profits and loss equally with effect from 8th July, 1940.

The partnership carried on business at different places. On 8th July, 1940, it was carrying on business in a building in Nanabhay Lane. That was

originally owned by the partnership but was sold to Mr. Devidas. On 8th July, 1940, the partnership was paying rent to Mr. Devidas for the

premises occupied by it. The partnership maintained books of account and in the previous years the partners were assessed on the footing of the

amounts withdrawn by them individually. That was taken as their income or profits from the business of the firm. For the assessment year 1940 a

question arose about the liability of the firm for its income for the accounting year 1939. On behalf of the assessees it was contended that on the

death of Mr. Devidas on 8th July, 1940, the firm was dissolved and its business was discontinued. As the firm of Messrs. Motichand and Devidas

was assessed to tax under the Act of 1918, the firm which was in existence up to 8th July, 1940, claimed relief u/s 25(3) of the Act. On behalf of

the Department it was urged that the firm had not discontinued its business of the old firm, and therefore no relief u/s 25(3) of the Act could be

given to them. In that connection it was pointed out that when Mr. Tanubhai was admitted as a partner in 1936 there was change in the constitution

of the firm, and if that firm is considered to be the firm which had discontinued its business, that firm had not been assessed to Income Tax under

the Act of 1918. It was contended that a mere change in the constitution of the firm did not amount to discontinuance of the business of the old firm

and relief u/s 25(3) was not permissible under the circumstances. In respect of the amount for which the firm was liable to be assessed, it was

urged by the Department that withdrawal is not ""a method of keeping accounts"" u/s 13 of the Act, and under that section withdrawal could not be

considered a method of accounting regularly employed by the assessees. To put it at its highest it may be considered a rough and ready method of

accounting. Under the Act only two methods are recognised as methods of accounting, viz., mercantile method and ""receipts"" and ""cash"" basis. As

the amounts withdrawn do not amount to a method for accounting, the Income Tax Officer was entitled to adopt the ""cash receipts"" method in

assessing the income. On these facts the Tribunal has referred the following two questions for the Courts opinion : (1) Whether, in the

circumstances of the case, there was discontinuance of the business or profession carried on by Messrs. Motichand and Devidas on 8th July,

1940, when Mr. Devidas died, so as to entitle the assessees to the relief provided by sub-section (3) of Section 25 of the Indian Income Tax Act,

1939 ? (2) Whether, in the circumstances of the case, the applicants were properly assessed on the ""receipts"" or ""cash"" basis ?

Dealing with the second question first, it appears to us clear that the Income Tax Officer was entitled to adopt the method of receipts or cash basis,

for assessing the income of the assessee firm. The fact that they had been assessed in the previous years on the footing of their withdrawals in each

year, cannot make it ""a method of accounting regularly employed by the assessee"" as it was not a method of accounting at all. In practice, this

should not work any injustice on the assessees because if they have not withdrawn the amounts in one year towards profits, they would withdraw it

in another year. On the other hand, it must be concealed that withdrawals are not the test of profits. Under the Act the question is what is the total

income of the assessees ? The answer that Rs. 80 so many were withdrawn by the partners is not an answer in accordance with the Act. The

profits or income of a Solicitors firm, speaking broadly are the profit costs of the firm, after defraying their expenses of keeping their office. For

instance if in a particular year the firm had completed 200 transactions of conveyancing and received in that year and earned in that year. If for any

reason the partners did not consider it necessary to withdraw money from the firm during the year., it will be wrong to contend that the profits of

the year were not the profit costs received by the firm during that year. It seems therefore that the conclusion of the Tribunal that the Income Tax

Officer was right in adopting the receipts or cash basis for ascertaining the income or profits of the firm is correct. The answer to the second

question is in the affirmative.

The first question falls into two parts. the first part is the question of construction of Section 25(3) as read with Section 26 of the Act. On behalf of

the Commissioner it was urged that discontinuance of the business or profession or vocation must mean a cessation of that business, as the word

discontinuance"" is ordinarily explained in dictionaries. It was contended that a change in the constitution of the firm did nor amount to a

discontinuance. it was argued that if the owner of a business was A and he sold the business to B the business still continued, and although relief

may be available u/s 25(4), on the ground of the assessee succeeding to the business of the previous assessee, no relief could be granted u/s 25(3),

because for that purpose the relevant question is ""has the business been discontinued ?"" The argument is that u/s 25(3) the point for consideration is

not, who is the assessee, who was doing business, but has the business continued or discontinued. In In re P.E. Polson, our High Court has held

that if a business carried on by A was sold to B, if A had paid Income Tax under the Act of 1918 he was entitled to get relief u/s 25(3). That case

has been doubted in O. Rm. M. SP. S.V. Meyyappa Chettiar v. Commissioner of Income Tax, Madras. I appreciate that there is force in the

reasoning of the Madras case. We are however bound by the decision in Polsons case and it is possible to decide the present reference without

going into this question of law. I do not propose to discuss it any more.

The second part of the question is : ""Has there been a discontinuance"" in the narrow sense of the word ? The question of law which has to be

decided in that connection is whether on the facts admitted or proved the firm of Messrs. Motichand and Devidas, which was in existence on 8th

July, 1940, has discontinued its business. In may opinion a discussion as to whether the firm of Messrs. Motichand and Devidas which came into

existence after 8th July, 1940, has succeeded to the business previously carried on by the firm in existence up to that date is not relevant for this

discussion. That discussion would be relevant if relief was claimed u/s 25(4) read with Section 26(2). For the purpose of the present discussion the

only question is whether the business of the old firm had been discontinued. I have already summarised at the commencement, the facts which are

noticed in the judgment of the Appellate Commissioner. The further relevant facts to which our attention has been drawn are these. The new firm

did not take over the business as a going concern. No outstandings or liabilities of the old firm were taken over by the new firm. The new firm had

started with new books and because the partners in the new firm were two out of the old firm they also worked to wind up the affairs of the old

firm. The business carried on after 8th July, 1940, was carried on in the name of Messrs. Motichand and Devidas which was the name used by the

old firm, and was carried on in the same premises in which the old firm had carried on business. In their judgment the Tribunal have stated as

follows :-

There is no disposal by assignment or otherwise in the present case. All that has occurred is that two partners of the old firm have reconstituted

themselves into a new firm and ace carrying on the business or profession which the old firm did, although under fresh retainers, in the same style,

in the same premises and in the same manner as before. On these facts, therefore, we do not think that the business of the old firm is discontinued.

The question is whether on the facts mentioned above the business of the old firm has discontinued.

The point of business being done in the same name may be taken first. In Arundale v. Bell, the partners of a firm of Solicitors agreed that the

partnership should be dissolved, that two of them should continue to carry on partnership business and should employ the third as a clerk, and that

all the books, papers and other properties of the firm should vest in and be the property of the two continuing partners. The third partner died and

on behalf of his estate a claim was made on the ground that the firm name was being used by the continuing partners. The claim was on the ground

of goodwill. The Court rejected the claim. Jessel, M.R., observed that as a general rule and in the absence of express contract there was not in a

partnership between Solicitors any partnership asset which was capable of being sold or valued as the goodwill of the partnership asset which was

capable of being sold or valued as the goodwill of the partnership business. The other Lords Justices agreed with the conclusion mentioned above.

Mr. Setalvad had relied on the statement of law found in Halsburys Laws of England, Vol. 31, page 285, where it is stated inter alia, that the

goodwill is asset in the hands of the administrator, who may assign it for value and it can be disposed of by will, or on the death of one of several

partners may pass, subject to the provisions of the articles, to the surviving partners. In support of that statement several cases decided in 1830

and 1850 are relied upon. Arundale v. Bell is a later decision and deals with the neat point whether a Solicitors firm as such has a goodwill in the

name of firm, apart from special stipulations and agreement between the parties. In my opinion, the principle as regards the goodwill of a Solicitors

firm as set out in that judgment applies to this case before us. It is also clear in law that upon the dissolution of a partnership between Solicitors,

without any sale or assignment of the goodwill of the business, and without any provision as to the use of the firm name, each of the partners is

entitled to carry on business in that name, provided that he does not by so doing expose his former partners to any risk or liability, which must

depend upon the circumstances of the case. It is therefore clear that in the absence of any agreement between the parties, on the dissolution of the

firm each partner is entitled to carry on business in the name of the old firm. The only limitation to that right is that he should not by his action

expose the outgoing partner or his estate to liability for the fresh business. Therefore, the fact that two partners continued to use the name of

Messrs. Motichand and Devidas after 8th July does not prevent the business of the old firm being discontinued.

The question of the business being carried on in the same premises, in my opinion, is equally immaterial. Ordinarily, that fact has to be taken into

account in considering the goodwill of a business. Apart from that, I do not know of any case in which the fact that the business was conducted in

the same place as before was considered relevant. In any event, the premises here were rented premises, and the evidence does not show that the

occupation of the premises carried with it any connection with the old business of Solicitors.

The statement of the Tribunal in their judgment that the business of the Solicitors was carried on in the same manner does not convey anything in

particular. The business of the firm was conducted by three Solicitors. It was the firm that was doing business. So long as the individual partners

are Solicitors, any business done by them as Solicitors must be in the same manner. To put it in other words a Solicitors business, whether

conducted by an individual or with others in partnership, must be conducted in the same manner. It was argued that in interpreting Section 25(3)

when the question arises in respect of the business of a firm of professional men, the business could be considered discontinued only when the

partners constituting the firm started an altogether different kind of business, e.g.., instead of working as Solicitors they started a business of stock-

brokers or dealers in cotton. In my opinion, there is no justification for going to that extreme and in the absence of authority I do not accept that

argument.

In the present case it is admitted that fresh retainers were taken by the new firm. A retainer is nothing more than an authority given by a principal to

the agent. On the charge in the partnership firm, as the firm will be a new firm, that is different from what is was before, in law, there would be a

different agent and therefore a fresh retainer will be necessary. That fact however does not affect the answer to the question whether there has

been discontinuance or not. In the present case there is nothing to show that anything which belonged to the old firm had been continued after 8th

July, 1940, except for the purpose of winding up the affairs of the old firm. The fact of new retainers being given indicated that the clients had

intimation that the business of the old firm had come to an end and if they wanted to employ the new firm fresh contracts had to be executed. In the

matter of a professional partnership a question arises, what is the business ? On the footing that business is a series of transactions involving giving

something by one party in consideration of something being given by the other party, a professional partnership gives the benefit or use of its

professional knowledge and experience to the client in consideration of the client paying the charges. The client is entitled to the benefit of the

knowledge and experience of the partners, and if that is incapable of being given after a particular date, it seems to me that here must be

discontinuance of the business. It was argued on behalf of the Commissioner that his conclusion would mean that in every case when there is a

change in the partnership there is a discontinuance of the business. I do not think that conclusion naturally follows. As an illustration, in this very

case, when Mr. Tanubhai was admitted in partnership, in my opinion, it cannot be contended that the business of the old firm has discontinued.

That firm continued, as a going concern, the business of the old firm. The clients became entitled to the knowledge and experience of the new

partner, in addition to the knowledge and the experience of the so far existing partners. There is thus a clear distinction between ""discontinuance"" of

a business and a ""change"" in business. Section 25(3) does not deal with a change in the business. It deals with the contingency of discontinuance of

the business. Applying another test to the facts here, it is clear that when Mr. Tanubhai was admitted as a partner, as required by the Partnership

Act, notice was given to the Registrar of Firms, intimating that there was a change in the partnership. After 8th July, 1940, when Mr. Motichand

and Mr. Tanubhai did business in the name of Messrs. Motichand and Devidas, they did not intimate that there was a change in the old firm, but

they filed a fresh application for the registration of the new firm, which thereafter transacted the business of Solicitors in that name. As I am unable

to find anything which shows that the business carried on by the old firm had been kept as if in a chain by the firm which came into existence after

8th July, in my opinion, the business of the old firm was discontinued from 8th July, 1940, and the assessees are entitled to the relief mentioned in

Section 25(3) of the Income Tax Act.

In considering equities I must point out that any other view would lead to the detriment of Mr. Devidass estate. Mr. Devidas had paid Income Tax

on the profits of the firm under the Act of 1918. If no relief is granted u/s 25(3) his estate will be paying double tax in respect of the assessment

year. I do not think that should be allowed unless the words of Section 25(3) clearly prevent the relief being granted. I would therefore answer the

first question in the affirmative.

CHAGLA, J. - I agree. In In re P.E. Polson, our High Court has given a more extensive meaning to the expression ""discontinued"" in Section 25 of

the Act than the Madras High Court has done in Meyyappa Chettiar v. Commissioner of Income Tax, Madras. But for the purpose of this

reference, we have agreed to accept the narrower construction of that expression which Mr. Setalvad for the Commissioner has contended for.

On that narrower construction the question which arise for our determination is whether on the death of Mr. Devidas on 8th July, 1940, there was

cessation of the business of Messrs. Motichand and Devidas carried on before that date. Now it is important to note that in this case the facts are

very significant. The new firm of Messrs. Motichand and Devidas did not take over the business of the old firm as a going concern with all its

assets and liabilities. No assets were taken over by the new firm and the new firm did not make itself liable for any debts of the old firm. As a

matter of fact the new firm opened new books of account and as has been pointed our in the judgment of the Tribunal retainers of the clients of the

old firm came to an end. The only importance which I attach to his fact, viz., that the retainers of the clients of the came to an end is that the new

firm did not take over the clients of the old firm and it was open to the clients of the old firm to engage the services of the new firm or not as they

pleased. Therefore on the fact it is clear to my mind that there was no nexus whatever between the old and the new firms. The only two facts on

which Mr. Setalvad relies or that the new firm carried on business in the same name and at the place as the old firm. As the name of Messrs.

Motichand and Devidas carried with it no goodwill and was no an asset of the old firm the mere fact of the two surviving partners using that name

is not material. As regards the place it was a rented premises and that by itself does not in any way help the contention of Mr. Setalvad.

Mr. Setalvad has really contended that u/s 25(3) the discontinuance of a profession means and must amount to the giving up of a profession, i.e.,

the changing over of one profession for another. Therefore according to him unless and until the surviving partners in the firm of Messrs. Motichand

and Devidas, viz., Mr. Motichand and Mr. Tanubhai ceased to practise as Solicitors, in law there cannot be a discontinuance of the profession.

Unless there is some authority which is binding on me I am not prepared to place that construction upon that expression in Section 25(3). Even the

case of Meyyappa Chettiar v. Commissioner of Income Tax does not go to that length. I therefore agree that the first question should be answered

as suggested by the learned Chief Justice.

With regard to the second question I have nothing further to add to what is stated by the learned Chief Justice in his judgment.

P.C. - Having heard counsel on the question of costs and bearing in mind the time spent in the arguments on points which each side has lost and

won we order that the Commissioner should pay half the costs of the reference.

Reference answered accordingly.