

(1958) 09 BOM CK 0031

Bombay High Court

Case No: Income Tax Reference No. 9 of 1958

Ratilal B. Daftari

APPELLANT

Vs

Commissioner of Income Tax,
Bombay City II

RESPONDENT

Date of Decision: Sept. 30, 1958

Acts Referred:

- Income Tax Act, 1922 - Section 23(5), 26A

Citation: (1959) 36 ITR 18

Hon'ble Judges: S.T. Desai, J; K.T. Desai, J

Bench: Division Bench

Advocate: M.B. Samarth, for the Appellant; G.N. Joshi, for the Respondent

Judgement

S.T. Desai, J.

This reference arises out of an assessment order made by the Department against a partner in the firm of Bombay Salt Dealers" Syndicate, where the contention of the assessee partners was that the share of profits which he received as a partner was not his income, but was income which he was bound to share with other persons under an agreement of the nature of a sub-partnership.

2. One Bhiwandiwalla and some other persons including the assessee entered into a partnership and carried on business in salt under the name and style of Bombay Salt Dealers" Syndicate. The agreement of partnership was in writing and was dated 6th October 1947. There were 16 partners and the partners between them contributed the capital of the firm which was Rs. 3,45,000, of which the contribution of the assessee was Rs. 25,000. The partners were to bear and share the losses and profits respectively in the firm in proportion to the capital contribution made by them. The share of the assessee came to 5/69th in the profit and loss of the business.

3. The Income Tax Officer took up the matter of the assessment of the firm for the year 1949-50 and determined the profits of the firm. The firm had applied for

registration which was granted. After determining the total income of the firm which was registered, the Income Tax Officer applied the provisions of section 23(5)(a) and the 5/69th share of the assess in the profits of the firm for the relevant year was determined at Rs. 14,661. The assessee admitted the source of income, but contended that the whole share of 5/69th in the partnership firm did not belong to him and that his own share was only 2/5th of that 5/69th share. According to him, the other 3/5th share of the same belonged to 4 persons, viz., Madhavji, Rameshwarlal, Mulshankar and Vrajilal. He relied on the agreement made between him and the four persons on 6th October, 1947, i.e., the same date on which the partnership agreement relating to the firm of Bombay Salt Dealers" Syndicate was executed. According to this agreement, the five parties to the same had diverse shares, they having contributed diverse amounts totaling up to Rs. 25,000. The agreement also recited that they were to share profits and bear the losses in proportion of their own individual contributions. It is also mentioned in that agreement that in the profits and losses of the partnership business (of Bombay Salt Dealers" Syndicate) and in all other respects, the terms and conditions relating to that firm contained in the agreement dated 6th October, 1947, were to be applicable to and binding on them. In substance and in effect, that was an agreement of partnership within a partnership. The Income Tax Officer decided that the arrangement between the assessee and the four other persons was only of the nature of an apportionment of profits after the assessee had earned them. He disallowed the contention and assessed the assessee in the whole amount of Rs. 14,661.

4. On appeal, the Appellate Assistant Commissioner took a contrary view. His conclusion was that the arrangement embodied in the writing executed by the five persons on 6th October, 1947, was in the nature of a sub-partnership between the assessee and the four others. He observed that the agreement between these persons was an agreement for diverting the income of the assessee by an overriding title and, therefore, it did not amount to a division of profits after accrual of the same as was found by the Income Tax Officer.

5. The matter was carried in appeal to the Tribunal. It was argued by Mr. Samarth, the learned counsel for the assessee, who also appears before us, that the assessee could only be assessed in respect of his "real income" and that the "real income" of the assessee was what his 2/5th share under the arrangement and agreement between the five persons brought to him. He also argued that the agreement had the effect of making an effective alienation at source by an overriding title created by it. The Tribunal rejected both the contentions urged on behalf of the assessee. The Tribunal has observed in its judgment that the theory of "real income" was being over-worked in the case before them. The Tribunal followed a decision of this court in the case of Dwarkadas Vassaanji. That case has little bearing on the case before us and we will only observe that Mr. G. N. Joshi, learned counsel for the Revenue, has not even drawn our attention to the same nor has he sought to rely on

it.

6. An attempt was made before the Tribunal on behalf of the Revenue to suggest that the agreement between the five persons, dated 6th October, 1947, was not a genuine one. The Tribunal did not allow the Revenue to raise that contention and the matter proceeded on the footing that the agreement of 6th October, 1947, which was executed on the same day on which the partnership agreement of what we may describe as the a print firm was also executed and the arrangement arrived at between the five persons, reflected the true position.

7. The question we are called upon to determine is :

"Whether, having regard to the provisions of sections 26A, 23(5)(a) , 16(1)(b) and the agreement dated 6th October, 1947, between the assessee and the four parsons, the sum of Rs. 14,661 or Rs. 5,864 shall be assessed in the hands of the assessee as the share in the profits of the registered firm, Bombay Salt Dealers" Syndicate."

8. A very short contention has been urged before us by Mr. Samarth, learned counsel for the assessee. The argument is that even in the case of a partner in a registered firm when the machinery laid down in section 23(5)(a) is applied, it is competent to the partner to urge that only his real income from the partnership business can be taxed, and that if any part of that income (profit) is diverted to any other person, for instance a sub-partner, by a legally binding agreement, then his "real income" cannot be the share allocated to him u/s 23(5)(a) ; but that his real income would be the amount that would remain with him after the profit apportioned to him is shared by him the sub-partner.

9. Mr. Samarth has relied upon a decision of this court in Seth Motilal Maneckchand v. Commissioner of Income Tax. The argument is that the ratio decidendi of that case wholly applies to the facts of the case before us. In that case, a managing agency belonged to a Hindu joint family consisting of A, his wife and his son B. In a partition between the three (the mother being entitled to a share) the managing agency was also divided and A and B (father and the son) became entitled to the managing agency remuneration in equal shares. It was, however, agreed that out of their shares of 8 annas each A and B should pay to A's wife 2 annas 8 pies each. The managing agency firm consisted thereafter of the two partners A and B and that firm was registered with the Income Tax authorities. In the assessment of the firm and each of the individual partners, both A and B claimed that the 2 annas 8 pies share share paid to A's wife by each of them should be deducted before ascertaining their taxable income. The contention that the amount of a sub-share was paid to A's wife, it was held, could not be taken into consideration in the assessment of the firm. But it was also held that that consideration did not prevent A and B, the partners, from claiming that their real income was not on the footing of 8 annas share in the managing agency commission but only of 8 annas shares less the amount which A's wife was entitled to receive from each of them. At the bottom

of page 739 in the report of that case, the learned Chief Justice observed as follows :

"But it is clear position in law, as we shall presently point out, that even though an assessee may not be allowed to claim a particular amount as a deduction falling within the provisions of the Act, he would be entitled to urge that his real income should be considered and if a certain amount is to be deducted in order to ascertain his real income, such a deduction would have to be made notwithstanding that the Income Tax Act made no provision for such a deduction. In all case of tax, what has got to be considered is what is the income of the assessee, and when that question arises what has got to be considered is the real income and not any artificial income, and for the purpose of ascertaining that real income every part of that income which may seem to be his income, if in fact it is not his income, if that part has been diverted and never constituted his real income, has got to be excluded."

10. Mr. Samarth has very strongly relied on these observations of the learned Chief Justice. Says Mr. Samarth, the amount paid to the sub-partners cannot be considered as the real income of the assessee. In the present setting, the share received by the assessee from the parent firm would be only his artificial income. Also, says Mr. Samarth, a part of that income paid out to the sub-partners was diverted and never constituted the real income of the assessee and, therefore, has got to be excluded. We see considerable force in the argument urged on behalf of the assessee.

11. This decision came up for consideration before my brother Justice Tendolkar and myself in *Sitaldas Tirathdas v. Commissioner of Income Tax*. In that case also we applied the test laid down in the case of *Seth Motilal Manekchand v. Commissioner of Income Tax*.

12. Mr. G. N. Joshi, learned counsel for the Revenue, has tried to distinguish that case on facts. According to Mr. Joshi, in that case there was a partition before the partnership agreement was executed and the partnership was actually a mode or method of giving effect to the partition and the managing agency was an asset of the family. Now, it is rarely that the facts of two cases may be identical or entirely similar. We are more concerned with the ratio decidendi of that case than the actual facts on which the decision turned. The principle asserted in that case is that even in the case of a partner in a registered firm, when the question arises as to his individual assessment, what is to be considered is not the income allocated to his share by employing the machinery of section 23(5)(a) , but his real income, and that real income is what remains after deducting the amounts which may be said to have been diverted and never constituted his real income and such amounts will have to be excluded before his real income is reached. We are in respectful agreement with the view taken by the learned Chief Justice and Mr. Justice Tendolkar in the case of *Seth Motilal Manekchand*. It is noted if there is any question of any deemed income in this case. It is not as if there is any legal action which comes into play in this case. Therefore, it is the real income of the partner which alone can be taxed whatever

may be the machinery that may be employed by the Revenue.

13. It was the mentioned by Mr. Joshi that if the claim of the assessee is allowed and we hold that it was not the amount of Rs. 14,661 but Rs. 5,864 in respect of which he can be assessed as his share in the profits of the business, then we would not be giving effect to the provisions of section 23(5)(a) and section 16(1)(b) of the Act and that the would be overlooking the basic principle of taxation of a firm underlying section 23. Broadly speaking, the basic principle underlying the taxation even of a firm is not the requirements of procedural matters, but what is the real income of the firm, and when a partner is to be assessed, what is the real income of the partner. In our judgment, in the case of a partner in a registered firm, ultimately it is his real income which alone can be taxed and not any artificial income that her may be said to have earned.

14. In the course of the arguments our attention was drawn to a judgment of a Division Bench of the Punjab High Court in Commissioner of Income Tax v. Laxmi Trading Company, where the view taken was that there could in law be a partnership between a partner in the parent firm and an outsider in respect of that partner's share in the parent firm and that in such a case the partners in the sub-partnership or the sub-firm have a right to apply for registration of the sub-partnership u/s 26A of the Income Tax Act. That was the view expressed in that case in the judgment delivered by Mr. Justice Kapur of that High Court (as he then was). The ratio and effect of that judgment as we radiate is that notwithstanding the machinery of section 23(5)(a) and notwithstanding the provisions relating tot he assessment of a firm and partners, it is competent to persons, who may be said to be in the position of sub-partners under one of the partners, to insist upon being recognised by the Income Tax Department and to insist upon registration of the sub-partnership firm. In such a case, it would be a partnership within a partnership and the Department would also have to recognise the sub-partnership or the sub-firm as an entity, which would be entitled to claim the benefit of the provisions contained in section 23(5)(a) . In view, however, of the conclusion we have already reached it is not necessary for us to pursue that question or discuss the implications of registration of a sub-partnership.

15. In the result, the assessee's contention must succeed. Our answer to the question will be that the sum of Rs. 5,864 shall be assessed in the hands of the assessee as his share in the profits of the registered firm and not the sum of Rs. 14,661. The Commissioner to pay the costs.

16. Reference answered accordingly.