

PETITIONER:
PAREKH WADILAL JIVANBHAI

Vs.

RESPONDENT:
COMMISSIONER OF INCOME-TAX, M. P. NAGPURAND BHANDARA, NAGPUR

DATE OF JUDGMENT:
28/10/1966

BENCH:
RAMASWAMI, V.
BENCH:
RAMASWAMI, V.
SHAH, J.C.
BHARGAVA, VISHISHTHA

CITATION:
1967 AIR 448 1967 SCR (1) 998

ACT:
Income-tax Act (11 of 1922), s. 26A-Registration of firm-
Whether individual shares of partners specified-Partnership
deed, construction of.

HEADNOTE:

Three brothers entered into a partnership in 1949 for doing business. Clause 3 of the partnership deed provided that the capital allotted to each partner was equal, and cl. 10 provided that after meeting all the expenses, interest and other charges, the resulting net profit or loss should be ascertained and divided amongst all the partners. In the assessment year 1951-52, the three partners applied to the Income-tax Officer for registration of the firm under s. 26A of the Income-tax Act, 1922 and registration was granted. For the assessment year 1952-53, the registration was renewed on application. But for the assessment year 1953-54 the Income-tax Officer refused renewal. In all the applications for registration, the three partners were shown to have shared the profits equally, and in their account books also, since 1949, the profits have been apportioned equally. The ground of refusal by the Income-tax Officer was, that there was no clause in the deed specifying the individual share of profits of each partner as required by s. 26A. The order was confirmed by the Appellate Assistant Commissioner, the Appellate Tribunal and the High Court on reference.

In appeal to this Court,

HELD : The assessee firm was entitled to be registered under s. 26A of the Act for the assessment year 1953-54 also.
[1003 D]

Although the application for registration had to be strictly in conformity with the section and Rules, in ascertaining whether the application was in such conformity the partnership deed has to be reasonably construed. Reading the partnership deed as a whole in the light of s. 13 of the Partnership Act, 1932, and in the context of the relevant circumstances of the case, there was specification of the individual shares of the three partners in the profits and losses namely, that each partner was allotted an equal one-third share and there was hence specification of the indivi-

dual shares of the partners within the meaning of the section, [1002 D-F]
Kylasa Sarabhalah v. Commissioner of Income-tax, [1965] 2 S.C.R. 310, followed.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1058 of 1965.

Appeal by special leave from the judgment and order dated March 14/15, 1961 of the Bombay High Court in Income-tax Reference No. 56 of 1960.

Arvind P. Patwe, O. C. Mathur, for the appellant.

S. T. Desai, A. N. Kirpal and R. N. Sachthey, for the respondent.

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The Judgment of the Court was delivered by Ramaswami, J. This appeal is brought, by special leave, on behalf of the assessee from the judgment of the Bombay High Court dated March 15, 1961 in Income-Tax Reference No. 56 of 1960.

The assessee is a partnership firm constituted under a Deed of Partnership dated March 19, 1950. The partners are three brothers- Nandlal Bhimjibhai, Tarachand Bhimjibhai and Rajnikant Bhimjibhai, each one having an equal 1/3rd share in the partnership firm. Prior to November, 1949, the three partners of the assessee-firm in partnership with eight others carried on business in Bombay and other places in the name and style of "Rajnikant Vitheldas & Co." In that larger firm, each one of the three brothers had an equal two annas share each, the other eight partners having the remaining ten anna share. The larger partnership of 'Rajnikant Vitheldas & Co.' was dissolved on October 31, 1949 and on its dissolution the business of the two branches thereof at Nagpur was allotted to the three brothers, who thereupon as from November 1, 1949 constituted themselves into a new firm, viz., the assessee-firm under the deed of partnership executed on March 19, 1950. This document recites that the three brothers have agreed to continue the business of the two branches at Nagpur in partnership on the terms mentioned in that document. For the purpose of this case, it is not necessary to reproduce all the terms of the partnership deed. It is sufficient to reproduce only four terms as follows :

"3. The capital of the partnership shall be Rs. 2,40,000/- (Rupees two lacs forty thousand) divided into 15 shares of Rs. 16,000/- each. The partners hereby agree that the shares allotted to different partners will be equal i.e., each partner will get five shares.

10. After meeting all expenses, interest and other charges, the resulting net profit or loss shall be ascertained and shall be divided amongst all partners.

13. In case of death, or insolvency of any partner the surviving partners or such of them as are willing shall have the rights to purchase the shares of such partners at the valuation of the shares in the preceding balance sheet.

14. In case of any partner desiring to retire from the partnership will have to give a written notice of at least two months to the

other partners of his intention to do so. On receipt of such notice, the remaining partner or partners will purchase the share or shares in pro-
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portion to their holding at the time the valuation in paragraph 13."

In the assessment year 1951-52, the three partners applied to the Income-tax Officer for registration of the firm under the Indian Income-tax Act, 1922 (hereinafter called the 'Act'). Along with this application, the deed of partnership dated March 19, 1950 was produced. By his order dated March 20, 1956 the Income-tax Officer granted registration under s. 26A of the Act for the assessment year 1951-52. On the same day, he determined the total income of the firm at Rs. 87,172/-, and under s. 23(6) of the Act, allocated it between the three partners for tax purposes, each partner getting one-third share of the total income i.e., Rs. 29,057 1/3. On the basis of the same deed, an application was made for the renewal of registration of the firm for the assessment year 1952-53. The renewal was granted- on March 28, 1957. For the assessment year 1953-54, the partners again applied for renewal of registration on the basis of the same deed, but the Income-tax Officer was of the opinion that there was no clause in the deed specifying the individual shares of each partner as required by s. 26A of the Act. After issuing notices to the three partners and after giving them a hearing, the Income-tax Officer, by his order dated March 28, 1958, rejected the application of the partners for renewal of registration of the firm. The assessee took the matter in appeal to the Appellate Assistant Commissioner but the appeal was dismissed. The assessee preferred a second appeal to the appellate Tribunal but that appeal also was dismissed. At the instance of the assessee the appellate Tribunal referred the following question of law for the determination of the High Court under s. 66(1) of the Act :

"Whether on a proper construction of the partnership deed dated 19-3-1950, the firm sought to be registered for the assessment year 1953-54, can be said to have been constituted under an instrument of partnership specifying the individual shares of the partners as required by section 26A of the Act ?"

By its judgment -dated March 15, 1961, the High Court answered the question in the negative, holding that renewal of registration under s. 26A of the Act was rightly refused by the Income-tax -authorities.

Section 26A of the Act provides as follows

"26A. Procedure in registration of firms. (1) Application may be made to the Income-tax Officer on behalf of any firm, constituted under an instrument of partnership specifying the individual shares of the partners,
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for registration for the purposes of this Act and of any other enactment for the time being in force relating to income-tax or Super-tax.

(2) The application shall be made by such person or persons, and at such times and shall contain such particulars and shall be in such form, and be verified in such manner, as may

be prescribed; and it shall be dealt with by the Income-tax Officer in such manner as may be prescribed."

By securing registration under the Act, the partners of the firm obtain a benefit of lower rates of assessment and no tax is directly charged on the income of the firm. This is an important benefit to which the partners of a registered firm become entitled as a consequence of registration and if it is intended to secure that benefit, the requirements of s. 26A of the Act and the Rules framed under the Act must be strictly complied with. Rule 2 of the Income-tax Rules framed under s. 59 of the Act requires that the application shall be signed by the partners (not being minors personally, and prescribes the period within which the application shall be made for the year in question. Rule 3 provides that the application shall be made in the prescribed form and shall be accompanied by the original instrument of partnership under which the firm is constituted, together with a copy thereof. It is provided by Rule 4 that if on receipt of the application, 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 writing at the foot of the instrument or certified copy, as the case may be, a certificate in the prescribed form. By rule 6 the certificate of registration granted under Rule 4 may be renewed for subsequent years. Section 4 of the Partnership Act defines "Partnership" as the 'relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Persons who have entered into partnership with one another are called individually 'partners' and collectively 'a firm', and the name 'under which their business is carried on is called the 'firm name'. Section 13 of the Partnership Act provides as follows :

"13. Subject to contract between the partners-

- (a) a partner is not entitled to receive remuneration for taking part in the conduct of the business;
- (b) the partners are entitled to share equally in the profits earned, and shall contribute equally to the losses sustained by the firm

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On behalf of the assessee the argument was put forward that the High Court was in error in holding that the assessee was not entitled to registration under s. 26A of the Act. It was submitted that on a proper construction of the various clauses of the partnership deed dated March 19, 1950 it should have been held that the shares of the three individual persons in the profits and losses were clearly specified, namely, that each partner was allotted an equal one-third share and there was hence specification of the individual shares of the partners within the meaning of s. 26A of the Act. In our opinion, the argument of the appellant is well-founded and must be accepted as correct. It is evident that under cl. (3) of the partnership deed, the capital allotted to each partner is equal, viz., 5 shares of Rs. 16,000/each in a total capital of Rs. 2,40,000/-. Clause (10) states that "after meeting all expenses, interest and other charges, the resulting net profit or loss shall be ascertained and shall be divided amongst all partners". It should also be noticed that in all the

applications for registration made by the assessee-firm under s. 26A of the Act the three partners have been shown to share the profits of the partnership firm equally. There is also the other circumstance that in the books of accounts for all the years since its commencement from November 1, 1949 right upto date the profits have been apportioned equally among the three partners of the partnership firm. Reading the partnership deed as a whole and in the context of the relevant circumstances of the case, we are of the opinion that there was specification of the individual shares of the partners in the profits within the meaning of s. 26A of the Act and the assessee-firm was entitled to registration for the assessment year in question. It was pointed out by this Court in *Kylasa Sarabhaiah v. Commissioner of Income-tax, Hyderabad*(1) that although the application for registration of a firm under s. 26A of the Act had strictly to be in conformity with the Act and the Rules, in ascertaining whether the application was in conformity with the Rules, the deed of partnership had to be reasonably construed. In that case, there were three major partners. In firm A in which four minors were admitted to the benefits of partnership. Its profits were to be shared equally between the seven persons whereas the losses were to be shared by the three major partners equally. A larger firm, firm B, was constituted, with five partners, under a deed of partnership in which firm A was described as the first partner and its members were collectively shown as having a share of 6 annas 9 pies in the profits of the larger firm. The fact that four minors were admitted to the benefits of partnership in firm A with equal shares in the profits but losses were to be shared only by its three major partners, was, however, recited in the preamble

(1) [1965] 2 S.C.R. 310: 56 I.T.R. 219.

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to the deed of partnership of firm B. The deed of partnership of firm B was signed by all the major partners of firm A. The question at issue was whether firm B was entitled to be registered under s. 26A of the Act. It was held that the firm was entitled to be registered and that registration could not be refused merely because the deed of partnership set out in paragraph 8 therein the collective share of the yarn shop as 6 annas 9 pies, for in the preamble the division of the shares of profits and losses among the three members of the yarn shop and those admitted to the benefits of the partnership was clearly indicated. It was, however, pointed out that the yarn shop as such was not introduced as a partner and the agreement was in truth between the three major members out of those who constituted the yarn shop and four outsiders. Each of them had signed the application and the covenants of the partnership agreement bind the partners individually. The indication in the deed of partnership that three of them held qua the yarn shop a certain relation did not affect their status as partners of the appellant-firm individually. The principle laid down in this case applies also to the present case and, for the reasons already expressed, we hold that the assessee-firm was entitled to be registered under s. 26A of the Act for the assessment year 1953-54 and the question referred to the High Court must be answered in the affirmative and in favour of the assessee-firm.

We accordingly allow this appeal with costs in this Court and the High Court.

V. P. S.

Appeal allowed.

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JUDIS