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**Court :** Mumbai

**Decided On :** Sep-06-1944

**Reported in :** [1946]14ITR534(Bom)

**Appeal No. :** Reference under Section 66(1) of the Indian Income-tax (XI of 1922) by the Income-tax Appellate Trib

**Appellant :** Motichand and Devidas in Re.

**Judgement :**

KANIA, Ag., C.J. - This is a reference made by the tribunal of Appeal under Section 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maintained books of account and in the previous years the partners were assessed on the footing of the amounts withdrawn by them individually.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 assesseees 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 under Section 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 under Section 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 under Section 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' under Section 13 of the Act, and under that section withdrawal could not be considered a method of accounting regularly employed by the assesseees. 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 not 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 under Section 25(4), on the ground of the assessee succeeding to the business of the previous assessee, no relief could be granted under Section 25(3), because for that purpose the relevant question is 'has the business been discontinued ?' The argument is that under Section 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 under Section 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 my 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 under Section 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 are 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 it 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 there 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 assessee is 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. Devidas's estate. Mr. Devidas had paid income-tax on the profits of the firm under the Act of 1918. If no relief is granted under Section 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 arises 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 out 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 old firm 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 under Section 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.

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