

S. Vs. M. Seyed Cassim, and Others V. Income-tax Officer, Karaikudi.

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Court : Chennai

Decided On : Apr-10-1963

Reported in : [1963]50ITR473(Mad)

Appeal No. : W. P. Nos. 966 to 971 of 1961

Appellant : S.

Respondent : M. Seyed Cassim, and Others V. Income-tax Officer, Karaikudi.

Judgement :

SRINIVASAN J. - These are petitions under section 226 of the Constitution praying that the records of the II-Income-tax Officer, Karaikudi, may be called for and the orders made in G. I. No. 5105-S/52-53, dated July 26, 1961, and other connected proceedings quashed.

It would be sufficient to set out the facts relevant to W. P. No. 966 of 1961. The petitioner herein was one of four partners of a firm called S. V. M. Mohammad Jalaluddin and Bros. This firm carried on business in Colombo for a long time. These partners are all brothers. On December 12, 1946, a company was incorporated in Ceylon under the name S. V. M. Mohammad Jalauddin and Bros. (Ceylon) Ltd. The firm of which the four brothers were partners transferred all the assets and liabilities of the firm including the firm name to this company under a document dated August 4, 1947. Thereafter, the firm ceased to exist and the limited company continued the business. The four brothers apparently became

directors of the company and were in receipt of bonus and salary from the company as well as dividends from the share which they held in the company. Subsequent to this altered state of things, each of the partners submitted returns of income each in his individual capacity. The firm having ceased to exist, it formally filed a 'nil' return declaring that it had ceased to exist from January 19, 1947.

The Income-tax Officer ignored the individual returns and declined to accept the factum of the transfer of the business with all its assets and liabilities to the limited company, and proceeded to apply section 44D of the Income-tax Act. In accordance therewith, he deemed the firm to continue to be in existence and deemed also that the entire accrued income of the company to be the income of the partnership and made an assessment as if the partnership continued to exist for all the assessment years up to 1953-54. An appeal was taken against the application of section 44D of the Income-tax Act. The Income-tax Appellate Tribunal held that section 44D was inapplicable and cancelled all the assessments made on the firm for the assessment years 1948-49 to 1953-54. The conclusion reached by the Tribunal was that the associated operations in connection with the transfer of the assets and liabilities of the firm to the company were bonafide and were taken out of the mischief of section 44D(1) of the Act by section 44D(3) thereof. It is stated in the petition that following this decision, the orders of assessment on the firm were cancelled. Nevertheless, the Income-tax Officer passed orders revising the assessments of the petitioner, which had been made on the basis of his individual returns for the years 1952-53 and 1953-54. The assessments were purportedly revised under section 35 of the Act, but what were included in the petitioners individual income thereby were the dividends, bonus and salary received from the company.

The principal contention of the petitioner is that section 35(5) of the Income-tax Act only confers jurisdiction upon the Income-tax Officer to revise the individual assessment of a partner on the making of an assessment or reassessment of the firm, and if it is found on such reassessment of the firm that any share of the partner in that firm had not been included in the assessment of the partner. According to the petitioner, what is now sought to be included is not any share

income of a partnership in a firm. The proceedings before the appropriate authorities resulted in the position that the firm had ceased to exist from 1947 onwards. The assessments on the firm had also been cancelled by accepting the 'nil' return following the findings of the Tribunal and also the High Court. If the income of the firm was nil, there was no share income of the partnership which could be brought into the assessment of the individual by the application of section 35(5) of the Act. In so far as the dividends and bonus or the salary received by the petitioner are concerned, they are receipts from the company. If it was part of the income which was taxable under the provisions of the Income-tax Act, it was open to the Income-tax Officer to resort to section 34 of the Act and to deal with those receipts as income escaping assessment. It was therefore contended by the petitioner that there was no foundation for the assumption of jurisdiction by the Income-tax Officer for invoking section 35 of the Act.

The six writ petitions have been filed by three of the partners of the defunct firm in respect of two assessment years 1952-53 and 1953-54.

On behalf of the Income-tax Officer, a counter-affidavit has been filed. The facts leading to the application of section 44D and the cancellation of the assessments on the firm following the proceedings before the Appellate Assistant Commissioner and the Appellate Tribunal as well as the High Court in T. C. No. 38 of 1958 are admitted. It is however contended that it is incorrect to say that the firm had ceased to exist; but that the entire proceedings had gone on, on the footing that the firm continued to exist. Even apart from that, it is contended that to the extent to which the bonus, the remuneration and the dividend were included in the assessment of the petitioner, they were already part of the original return and that the recomputation of the net taxability of the petitioner is not necessarily one under section 35 but was intended to give effect to the extent necessary in consequence of the Appellate Tribunal's decision. For these reasons it is claimed that the attack upon the jurisdiction of the Income-tax Officer is not substantiated and that the petitions should be dismissed.

In the reply affidavit filed on behalf of the petitioners, it is pointed out that the firm had ceased to exist. Since the department had refused to accept that position, by

way of abundant caution these petitioners had to make applications for renewal of registration of the firm under protest in order that in the event of the firm being declared to continue in existence, they could at least have the benefit of the lower rates of taxation available to registered firms. It is pointed out in the reply affidavit that when once the matter was concluded by the decisions of the Appellate Tribunal, followed by the reference to the High Court, the fiction that the firm continued to exist must come to an end. The correctness of the plea of the Income-tax Officer that since the salary and bonus stood included in the original assessments, they could still be maintained despite the fact that they were not receipts of any share of the profits of the firm is questioned.

The decision of the Tribunal on the question of the applicability of section 44D of the Act was rendered on 9th March, 1957. The Tribunal specifically held that the transfer of the assets and liabilities including the goodwill of the firm to the company was motivated by bona fide business considerations only and that there was no intent to avoid or reduce the tax liability. All the assessments made upon the firm were accordingly cancelled. The department attacked the correctness of the conclusion of the Tribunal and sought for and obtained a reference to the High Court. This reference, T. C. No. 38 of 1958, was disposed of by a Bench of this court to which one of us was a party. This court upheld the conclusion reached by the Tribunal that the dominant object in the formation of the company was not the avoidance of the tax but purely a commercial one with a view to advance the prospects and continuity and success of the company and that any benefit with regard to the Indian Income-tax Act was purely incidental to and as a consequence of the formation of the company. The reference was accordingly answered against the department.

It seems to be obvious that the resulting position is that the firm ceased to exist with effect from the date of the transfer of its assets and liabilities to the company, and if the firm ceased to exist, we cannot conceive of a position where the partnership still continued to be in existence. The partnership was definitely put an end to by the act of the parties and it would be a misreading of the judgment of this court to hold that notwithstanding the acceptance of the facts outlined above, this court held that the firm continued to be in existence. Section 44D(1) only declares

that in certain circumstances a person who has transferred the assets shall still be deemed to be in receipt of the income for all purposes of the Act. Whether or not the finding of this court involves a further finding that the partnership had ceased to exist, it at least establishes that the income in question, which is that of the transferee company, cannot be deemed to be the income of the transferor firm. The result of the decision is clearly that the firm was not in receipt of the income that was sought to be brought to tax in this case. Even giving the decisions of the Tribunal and this court a limited construction, viz., that the income sought to be included was not the income of the firm, it necessarily follows that even on the assumption that the partnership continued to exist, the partners could not have been in receipt of any income which represented a share of the income of the firm, which, to repeat, was held by this court could not be deemed to be the income of the firm. If the firm had no taxable income and indeed no income, equally so the partner derives no income from the firm.

When once that position is reached, the result is that there was no foundation for the revision of the assessment of the partners. The vague argument that to the extent to which the petitioners in these cases were in receipt of salary or bonus, that could be brought into assessment by these proceedings wholly fails to impress us. Mr. Ranganathan cannot contend that if it is held that the firm had no income and a revision of the partners assessment was not justified by the terms of section 35(5) of the Act he can still appeal to that section for effecting a revision of the petitioners assessments by including income which was not derived from the partnership. Mr. Karim, learned counsel for the petitioners, is certainly well founded in his arguments that these items of income referred to, which were derived from the company, could only be regarded as income escaping assessment and could not be brought in except by resort to section 34. It is not pretended that that provision of law was invoked.

We are accordingly satisfied that the revision of assessments in these cases, purportedly only under section 35(5) of the Act, were wholly devoid of jurisdiction. The petitions are accordingly allowed. The revised orders of assessment are quashed. The petitioners are entitled to their costs. Counsel's fee in W. P. No. 966 of 1961 only Rs. 200.

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