

CIVIL REFERENCE

Before Bhandari, C. J. and Chopra, J.

M/S RAMJI DAS-RIKHI RAM,—Applicant.

versus

THE COMMISSIONER OF INCOME-TAX PUNJAB, PEPSU
HIMACHAL PRADESH AND BAILASPUR,
SIMLA,—Respondent.

Civil Income-tax Reference No. 2 of 1953

1958

April 24th

Indian Income-tax (XI of 1922)—Section 26A—Partnership—Definition of—Income-tax Act recognises only partnership constituted under an instrument of partnership—“Constituted under an instrument of Partnership”—Interpretation of—Registration of a partnership under section 26A. Condition precedent for—Partnership established under an oral agreement—Procedure for taking benefit of section 26A stated.

Held, that a partnership may be stated broadly to be a relationship between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. One of the chief characteristic of the partnership relation is that it is created only by the voluntary agreement of the parties. The agreement may be oral or in writing, or it may be express or implied but an agreement must precede the creation of the relationship. The element of agreement is fundamental.

Held, that the Income-tax Act does not take notice of any partnership which came into existence as the result of an oral agreement; it recognises only partnerships which are constituted under an instrument of partnership. If any

persons wish to take advantage of the lower rates of assessment applicable to partnerships, they must constitute the firm *under* an instrument of partnership. The writing must be one by virtue of which the partnership has been established. No particular form of language is necessary to constitute an instrument of partnership.

Held further, that the precise meaning that should be attached to a word which is not purely technical often depends upon the connection in which it is used and with reference to the subject-matter treated. The expressions "Constituted under" and "Constituted by" when used with reference to an instrument of partnership convey the same idea and mean the same thing. This interpretation is in consonance with sound public policy, principles of justice, the object of the statute and the manifest intention of the Legislature.

Held also, that as partnerships are formed by mutual agreement of all parties, they may be altered, modified or dissolved by like agreement. If, therefore, a partnership which has been established under an oral agreement is anxious to obtain the benefit of section 26A, all that is necessary is that this partnership should execute another instrument of partnership declaring that hence forward the provisions of the instrument will regulate the relations of the partners. If the instrument declares expressly or by necessary implication that the partnership would be created under this instrument, the conditions set out in section 26A would be completely satisfied. If on the other hand the document is merely a memorandum of an oral transaction and does not by itself constitute or create the partnership, it cannot achieve the object which the framers of the instrument may have had in view.

Messrs Ram Ghulam Madan Lal v. Income-tax Officer (1), *R. C. Mittar and Sons v. Commissioner of Income-tax* (2), *relied upon. Dwarka Das Khetan and Co. v. Commissioner of Income-tax, Bombay* (3), *not followed. Re East and West India Dock Co.* (4), *Alson v. Pierce* (5), and *Powell v. City of Bair* (6), referred to.

(1) (1954) 25 I.T.R. 339

(2) (1955) 28 I.T.R. 893

(3) (1956) 29 I.T.R. 903

(4) (1888) 38 Ch. D. 576

(5) 1950 2nd 799

(6) 128 S.W. 2nd 786, 790

Case referred under Section 66(1) of the Indian Income-Tax Act by the Income-tax Appellate Tribunal (Delhi Bench), consisting of Mr. Sehgal, Accountant, Member, and Mr. Rajagopal Sastri, Judicial Member, on the 20th January, 1953, for decision of the legal point involved in the case.

D. K. MAHAJAN, GANGA PARSHAD AND P. C. JAIN, for Applicant.

S. M. SIKRI, Advocate-General and H. R. MAHAJAN, for Respondent.

ORDER

Bhandari, C. J.

BHANDARI, C.J.—This is a reference under section 66(1) of the Indian Income-tax Act. On the 10th April, 1948, Rattan Lal, and his brother Jai Parkash entered into an oral agreement to carry on business in partnership under the name and style of Messrs Ramji Dass-Rikhi Ram and on the 17th October, 1948, they reduced the terms of this agreement into writing. On a later date they made an application to the Income-tax Officer to register their firm under the provisions of section 26A of the Income-tax Act for the assessment for 1949-50 (previous year, ending 31st March, 1949). The Income-tax Officer came to the conclusion that no genuine firm had come into existence in April, 1948, and his conclusion in this behalf was confirmed by the Appellate Assistant Commissioner. The Tribunal, however, came to a contrary conclusion. It held that although a genuine firm was constituted in April, 1948, the instrument of partnership was drawn up only on the 17th October, 1948, and the firm cannot be said to have been “constituted under an instrument of partnership”. In this view of the case the Tribunal dismissed the appeal in so far as the firm’s registration under section 26A was concerned. At

the request of the parties the Tribunal has referred the following question of law to this Court, namely:—

“Whether the applicant firm which was formed by oral agreement in April, 1948, on terms and conditions reduced to writing in October, 1948 was one constituted under an instrument of partnership within the meaning of those words in section 26A and entitled to registration for the purposes of the Income-tax Act, for the assessment year, 1949-50 ?”

Messrs. Ramji
Das-Rikhi Ram
v.

The Commis-
sioner of Income-
Tax, Punjab,
Pepsu, Himachal
Pradesh and
Bilaspur, Simla

Bhandari, C. J.

Although, it is difficult to give a definition of partnership which is accurate, comprehensive and exclusive, a partnership may be stated broadly to be a relationship between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. The Indian Income-tax Act does not take notice of any partnerships which come into existence as the result of an oral agreement, for section 26A provides quite clearly that application can be made only on behalf of any firm “constituted under an instrument of partnership.” One of the chief characteristics of the partnership relation is that it is created only by the voluntary agreement of the parties. The agreement may be oral or in writing or it may be express or implied, but an agreement must precede the creation of the relationship. The element of agreement is fundamental. The Income-tax Act, does not take notice of any partnerships which come into existence as the result of an oral agreement ; it recognises only partnerships which are constituted under an instrument of partnership. If, therefore, any persons wish to take advantage of the lower rates of assessment applicable to partnerships, they must constitute the firm under an instrument of partnership. This is clear from the language

Messrs. Ramji
Das-Rikhi Ram
v.

The Commis-
sioner of Income-
Tax, Punjab,
Pepsu, Himachal
Pradesh and
Bilaspur, Simla

Bhandari, C. J.

which the Legislature has chosen to employ, for section 26A of the Income-tax Act provides—

“26-A (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, 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.”

The expression “constituted under an instrument of partnership” has come up for judicial interpretation in certain cases in this country. Two different sets of views have been expressed. According to one view section 26A does not require that the firm for the registration of which the application is made, must be constituted by the instrument of partnership, or that it must come into existence by reason of the instrument of partnership, or that the firm should be the creature of the partnership, or that the firm must not exist prior to the execution of the instrument of partnership. It provides merely that it should be constituted under an instrument of partnership. The expression “under” is not synonymous with the expression “by”. It follows as a consequence that a firm which has come into existence as the result of an oral agreement is entitled to registration with effect from the date on which it came into existence, provided of course an instrument of partnership was executed subsequently. This view has been expressed by Chagla, C.J., in *Dwarka Das Khetan and Co. v. Commissioner of Income-tax, Bombay* (1).

According to the second view the instrument of partnership by which the firm was constituted, must be an instrument executed at or before the commencement of the relative accounting year and an instrument which governs the distribution of the profits in

that year. It should be an instrument which forms part of the transaction which results in the creation of the partnership and should not be an instrument which merely records previous history and declares in the usual phraseology that the parties desire that the terms of the agreement should be placed on record. This view has been propounded by this Court in *Messrs Ram Gulam-Madan Lal v. Income-tax Officer, G. Ward, Delhi* (1), and by the Calcutta High Court in *R. C. Mittar and Sons v. Commissioner of Income-tax* (2), In the Calcutta case Chakravarti, C.J., observed as follows :—

Messrs. Ramji
Das-Rikhi Ram
v.
The Commis-
sioner of Income-
Tax, Punjab,
Pepsu, Himachal
Pradesh and
Bilaspur, Simla
Bhandari, C. J.

“I should, therefore, think that the clear and unambiguous meaning of the expression ‘instrument of partnership’ must rule the construction of the controversial words in section 26A and so far as the language of that section is concerned, it must be held that it contemplates firms created or brought into existence by a deed in writing and further that it contemplates a deed which governs the distribution of shares in the relevant accounting period.”

The learned Chief Justice accordingly propounded the following four principles regarding registration of firms:—

- (1) Where a deed of partnership executed on a certain date merely states that it shall be deemed to have come into existence at an earlier date, that does not create a partnership from that earlier date.
- (2) Where the partnership has originated in a verbal agreement and after it has existed

(1) (1954) 25 I.T.R. 399

(2) (1955) 28 I.T.R. 698

Messrs. Ramji
Das-Rikhi Ram

v.

The Commis-
sioner of Income-
Tax, Punjab,
Pepsu, Himachal
Pradesh and
Bilaspur, Simla

Bhandari, C. J

for some time, a formal deed of partnership is executed, so far as the period prior to the date of the deed is concerned, there cannot possibly be any claim to registration.

- (3) It does not, however, follow that in every such case, registration can be claimed as of right with respect to the period subsequent to the date of the deed. Whether or not such a claim is sustainable will depend upon the language of the instrument. If the instrument merely records the earlier origin of the partnership and the agreement then entered into, and says in the usual phraseology that the parties desire that the terms of the agreement should be placed on record, no partnership is constituted by the deed even with respect to the period subsequent to its execution. The deed in such a case is merely a deed of declaratory character or a memorandum.
- (4) If, however, in addition to recording the earlier origin of the firm in a verbal agreement and its subsequent history, the deed also states that the partners shall carry on business in future in accordance with its terms, it can, and should, be construed as creating or originating a partnership for the future as from its date, and only in such case can an instrument of such a composite character be made the basis of a claim to registration with respect to the subsequent period.

I must confess with great regret that I am unable to concur in the first view and must unhesitatingly endorse the second. The purpose of section 26A is to prevent the enforcement of unfounded claims for

relief from taxation by requiring that agreements of partnership should be evidenced by a writing, for it is not safe to let proof of the existence of partnerships rest in parol. It is designed to protect the State from fraud and perjury, to remove uncertainty and prevent imposition through the assertion of false claims, to reduce the dangers from the enforcement of fraudulent claims by the use of oral evidence alone, to secure written evidence of the existence of partnerships, and to obviate the possibility of valuable official time being wasted in ascertaining by parol the precise date on which a particular partnership came into existence. It requires that a firm which is desirous of obtaining the benefits of low rates of income-tax applicable to partnerships must be constituted under an instrument of partnership.

The expression "constitute" means to "set up", "establish", or "found". It is not equivalent to "incorporated". It is of wider import. It seems to be equivalent to "established" (*Re East and West India Dock Company* (1)). The word "under" has various meanings. It means "by", "by reason of", "by means of", "by virtue of", or "because of". It has the same signification as the phrase "by virtue of" which is defined in the Century Dictionary as meaning "by or through the authority of". It is also defined "in subordination to" (*Worcester Dictionary*) and "in conformity with" (*Century Dictionary*). It may mean "in accordance with" or "in conformity with". It may be used in a statute in its literal sense as indicating condition of inferiority or subservience, or as meaning subject to or in conformity with, denoting curtailment or restriction of, but nevertheless agreement or congruity with, something else to which it is made applicable (*Alsop v. Pierce* (1)). The words "under" and "by" when used with reference to the crime of obtaining money by false pretences mean the

Messrs. Ramji
Das-Rikhi Ram
v.

The Commis-
sioner of Income-
Tax, Punjab,
Pepsu, Himachal
Pradesh and
Bilaspur, Simla

Bhandari, C. J.

(1) (1888) 38 Ch. D. 576.

(2) 19 So. 2nd 799, 802.

Messrs. Ramji
Das-Rikhi Ram
v.

The Commis-
sioner of Income-
Tax, Punjab,
Pepsu, Himachal
Pradesh and
Bilaspur, Simla

Bhandari, C. J.

same thing (43 Words and Phrases Under). A poll tax levied by a city, by authority of a statute is levied "under" state laws, "under" being used as a preposition, indicating subjection, guidance or control, and meaning "by authority of" (*Powell v. City of Bair* (1)). The precise meaning that should be attached to a word which is not purely technical often depends upon the connection in which it is used and with reference to the subject matter treated. I am of the opinion that the expressions "constituted under", and "constituted by" when used with reference to an instrument of partnership convey the same idea, and mean the same thing. This interpretation appears to me to be consonant with sound public policy, principles of justice, the object of the statute and the manifest intention of the Legislature.

Now, what was the intention of the Legislature when, it declared in section 26A that the firm must be "constituted under" an instrument of partnership? The Legislature could not have intended that it may be established under an oral agreement. If that had been the intention, there would have been no real purpose in requiring that it should be constituted under a written instrument. Nor could the Legislature have intended that although the firm was established under an oral agreement, it should be entitled to the privileges conferred by section 26A only if the terms and conditions of the agreement are reduced into writing several months after the partnership had come into being. If that had been the intention the Legislature would not have curtailed the power of registration—as undoubtedly it has—by subjecting it to the limitation that the firm should be constituted "under" an instrument of partnership. The Legislature could have had no difficulty in declaring that the benefits of registration would be available to every partnership, however, constituted, the terms of which have been reduced into writing.

I am clearly of the opinion that before a partnership can claim registration it must satisfy the appropriate authority that it was constituted by or under an instrument of partnership. The writing must be one by virtue of which the partnership has been established. No particular form of language is necessary to constitute an instrument of partnership. A memorandum wholly non-technical in form may be sufficient. It may consist of any kind of writing from a solemn deed down to mere hasty notes but it must be an instrument by virtue of which the partnership is created.

Messrs. Ramji
Das-Rikhi Ram
v.
The Commis-
sioner of Income-
Tax, Punjab,
Pepsu, Himachal
Pradesh and
Bilaspur, Simla
Bhandari, C. J.

A question at once arises : How should a partnership, which was established under an oral agreement, proceed if it wishes to claim the benefit of section 26A of the Income-tax Act? The answer is simple. As partnerships are formed by the mutual agreement of all parties they may be altered, modified or dissolved by like agreement. If, therefore, a partnership which has been established under an oral agreement is anxious to obtain the benefit of section 26A all that is necessary is that this partnership should execute another instrument of partnership declaring that henceforward the provisions of the instrument will regulate the relations of the partners. If the instrument declares expressly or by necessary implication that the partnership would be created under this instrument, the conditions set out in section 26A would be completely satisfied. If on the other hand the document is merely a memorandum of an oral transaction and does not by itself constitute or create the partnership, it cannot achieve the object which the framers of the instrument may have had in view.

This brings me to the consideration of the question which has been referred to us for decision, viz., whether the applicant firm which was formed by an

Messrs. Ramji Das-Rikhi Ram v. The Commissioner of Income-Tax, Punjab, Pepsu, Himachal Pradesh and Bilaspur, Simla

oral agreement in April, 1948, on terms and conditions reduced to writing in October, 1948, was constituted under an instrument of partnership and entitled to registration for the assessment year, 1949-50. The answer is clearly in the negative. This partnership owed its birth and creation to an oral agreement which was entered into in April, 1948, and not to the so-called instrument of partnership which was executed in October, 1948, with the avowed object of reducing into writing the arrangement which had been agreed upon six months previously. For the reasons mentioned above it is obvious that the firm cannot claim the benefit of section 26A prior to the date on which the document was executed.

Bhandari, C. J.

We are now confronted with the question whether the firm can claim the benefit of this section even after the 17th October, 1948, when the instrument was executed. This question too must be answered in the negative. This instrument declares that Rattan Lal and Jai Parkash constituted a joint family and were carrying on joint family business at Jagadhari, that on account of diverse reasons the parties had mutually agreed to partition the joint family business and to carry on business as a separate partnership concern, that the business had been carried on as a separate concern with effect from the 10th April, 1948, that there was no proper instrument to witness the arrangements which had been arrived at between the parties and that it was essential to reduce the terms of the partnership into writing to obviate the possibility of doubts arising. The firm was not constituted by or under this instrument for the instrument does not declare that it had brought a partnership into existence or that a partnership which had already been formed under an oral agreement was being continued under the provisions of the instrument. It merely recites that a partnership was formed by means of an oral agreement on

the 10th April, 1948, and sets out the terms and conditions of the oral agreement. It does not create a new partnership; it does not recreate an old partnership, it does not regulate the distribution of shares between the several partners in the relevant accounting period. It merely contains a recital of the terms of the partnership which had been entered into several months before. It has been strongly pressed upon us that the benefit of section 26A should be extended to this firm, at least with effect from the 17th October, 1948, when the instrument was reduced to writing, and our attention has been invited to *Messrs Ram Gulam Madan Lal v. Income-tax Officer, G. Ward, Delhi* (1), where Falshaw, J., observed as follows:—

Messrs. Ramji
Das-Rikhi Ram
v.

The Commis-
sioner of Income-
Tax, Punjab,
Pepsu, Himachal
Pradesh and
Bilaspur, Simla

Bhandari, C. J.

“Obviously as we held in the case referred to above, the deed or instrument cannot possibly have retrospective effect as regards the income-tax assessment of the firm, but I cannot see any objection to the firm’s being treated as constituted under the instrument as from the date of the instrument itself. It may be that the partners in these firms act foolishly in alleging the previous existence of the partnership on the same terms in the vain hope of securing retrospective concessions, and in the most literal sense of the words a partnership cannot be said to be constituted under an instrument when admittedly it has been in existence previously. On the other hand the intention of the law is clear, that when partners do draw up an agreement by which their shares in the partnership profits are specified, they are entitled to have the partnership registered under the Act, and thus to have individual

(1) (1954) 25 I.T.R. 339

Messrs. Ramji
Das Rikhi Ram
v.

The Commis-
sioner of Income-
Tax, Punjab,
Pepsu, Himachal
Pradesh and
Bilaspur, Simla

Bhandari, C. J.

shares of the partners assessed for income-tax, and it seems to me to be an unduly harsh interpretation of the law to say that because the partners say they have been partners previously, they should not be entitled to have the partnership registered even when they have embodied its terms in a deed. I am, accordingly of the opinion that when a deed or instrument of partnership is presented for registration under section 26A, even where the partnership is alleged in the deed to have existed previously on the same terms, this should not be a bar to the registration of the firm, and it should be treated as constituted under the instrument as from the date of the instrument."

Although I was a party to the above decision I must confess with great regret that I am unable to support this view which appears to have been recorded somewhat hastily. The question which must arise in every such case is whether the firm has been constituted under an instrument of partnership, whether it owed its birth and creation to the said instrument. If the firm has been constituted not under an instrument of partnership but under an oral agreement, it is obvious that it cannot claim the benefit of section 26A. But, I can see no legal objection to a firm which has been constituted under an oral agreement dissolving itself and reconstituting itself into a new firm under an instrument of partnership. If, it is constituted or reconstituted under a deed of partnership, it will certainly be entitled to all the privileges of registration. If, on the other hand, it is not constituted or reconstituted under an instrument of partnership and if the so-called instrument of partnership is nothing more than a memorandum of what had taken place before it cannot be deemed to be an

instrument contemplated by section 26A. I find myself in respectful agreement with the view taken by the Calcutta High Court that when the instrument merely records the earlier origin of the partnership and the agreement then entered into and says that the terms of the agreement should be placed on record, no partnership is constituted by the deed even with respect to the period subsequent to its execution. The present instrument recites only the past history and does not constitute or reconstitute the firm. It seems to me, therefore, that this firm is not entitled to be registered under section 26A.

For these reasons I am of the opinion that the firm in question was not constituted under an instrument of partnership and that it is not entitled to registration for the assessment year, 1949-50. No order as to costs.

CHOPRA, J.—I agree.

K.S.K.

Messrs. Ramji-
Das Rikhi Ram
v.
The Commis-
sioner of Income-
Tax, Punjab;
Pepsu, Himachal
Pradesh and
Bailaspur, Simla
Bhandari, C. J.

Chopra, J.