

Lalli Ram Sunderlal Jhansi vs Re. on 4 October, 1950

Equivalent citations: [1951]19ITR372(ALL)

JUDGMENT

The following question has been referred to us by the Income-tax Appellate Tribunal, Allahabad Bench, under Section 66(1) of the Indian Income-tax Act for our opinion :-

"Whether, in the circumstances of the case and on a correct construction of the deed of partnership, dated the of April 3, 1945, a genuine partnership can be inferred ?"

The assessee firm Lalli Ram Sunder Lal was assessed upto the assessment year 1944-45 as a Hindu undivided family firm. On the of April 3, 1944, one Ram Charan Sarogia, representing this Hindu undivided family, entered into a deed of partnership with two brothers, Ram Charan Laharia and Govind Das. The agreement of partnership laid down that Ram Charan Sarogia representing the first party and Ram Charan Laharia and Govind Das constituting the Second party would be entitled to profits and would bear the losses in equal shares. An application was presented for registration of this deed of partnership under Section 26A of the Indian Income-tax Act during the assessment year 1945-46. The Income-tax Officer rejected this application and the appeals to the Appellate Assistant Commissioner of Income-tax and to the Income-tax Appellate Tribunal failed. The assessee firm, therefore, applied for a reference to this Court.

The statement of the case forwarded by the Tribunal incorporates a translation of the partnership deed, dated the of April 3, 1944, as an appendix. This deed clearly lays down that the two parties to it would be entitled to profits and would bear losses in equal shares after deducting one anna in the rupee out of the profits for the temple of Shri Thakur Ji Rashiq Siromaniji situated in Rambagh outside Laxmi Gate, Jhansi. In section 4 of the Indian Partnership Act, partnership has been defined 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." The deed in question clearly provides for the sharing of profits between the two parties to it. In addition, there is also a clear provision for the sharing of losses, these provisions for the sharing of profits and losses raise a very strong presumption that this deed creates a partnership.

It was contended by the learned counsel of the Department that an examination of other terms of the deed would show that though there were provisions for the sharing of profits and losses, this document really purported to give to party No. 2 the status of an agent or a servant and did not really bring into existence a partnership. It was further contended that, in any case, it did not create a genuine partnership. So far as the second contention is concerned, the statement of the case by the Income-tax Appellate Tribunal shows that the Tribunal nowhere found that the agreement in question was not genuine and was a colourable transaction. Even in the appellate order passed by the Tribunal, it was clearly mentioned that "the point for determination in the appeal is whether on a proper construction of the terms of the deed of partnership, dated April 3, 1944, on the basis of which registration is sought, a genuine partnership has come into existence." It is, therefore, quite

clear that the Tribunal never considered that the genuineness of the terms of the deed itself was at all in doubt. The only point that was considered and decided was whether the terms of the deed itself constituted a legal partnership. There being no consideration of the question of genuineness of the transaction by the Tribunal, this point cannot be taken into account by us in giving our opinion on the question referred to us.

On the construction of the deed itself as we have said above a strong presumption arises that a partnership came into existence due to the provisions that the two parties to the agreement were to be entitled to profits and to bear losses in equal shares. The provisions in the contract about the liability to bear losses in equal shares is ordinarily much more consistent with the constitution of a partnership than with any other relationship between the contracting parties. There can, of course, be cases where, under special circumstances, the parties to the agreement may be sharing both profits & losses and yet they may not be partners. This will, however, depend on the individual circumstances of each and it will have to be seen whether, in the particular case under discussion, such special circumstances have been shown as would be enough to rebut the presumption of partnership arising out of the agreement to share profits & losses in equal shares. In the present case an examination of the agreement deed shows that there are no such special circumstances in existence. There is no doubt that, under the agreement, all the assets of Firm Lalli Ram Sunder Lal were to continue to belong to the first party and even ownership of the firm was to vest in the first party. This means that the rights under the goodwill of the firm were also to belong to the first party. The second party was further debarred from the right of borrowing money for partnership business without the consent of the first party. None of these provisions is, however, inconsistent with the existence of partnership. It is not essential that, in a partnership, all the contracting parties should be owners of the assets or the goodwill of the firm, nor is it necessary that the right of borrowing money on behalf of the partnership business should be exercisable by every partner.

The further provisions of the agreement deed relate to the manner of dissolution of the partnership business. In paragraph 7 of the agreement deed, it was laid down that if any dishonesty of party No. 2 was found, or, due to his action, there was loss to the business, or some bad slur was given to the goodwill of the firm, then party No. 1 would have a right to dissolve a partnership. This right of the dissolution of the partnership was again, in no way, inconsistent with the existence of a legal partnership and did not create a contract by which a second party could be considered to be the servant or agent of party No. 1. Under the agreement deed party No. 2 was to do the whole business with great skill and honesty and since his contribution in the partnership was to consist of his personal services it was not unnatural that provision should have been made for the dissolution of the partnership at the instance of party No. 1 in case the action of party No. 2 dishonesty or gave bad name to the firm.

Paragraph 13 of the agreement deed, on which considerable emphasis was laid by the learned counsel for the Department, only lays down that the second party was to be entitled to withdraw its share of the profits of the partnership business after they had accumulated to such an extent that they exceeded the amount of money invested in the partnership business by the first party. It was contended that this provision under which party No. 2 was not to get any share in the profits for a number of years, very likely for a period of as many as seven years since the profits in the first year

was only about Rs. 7000 and the investment by party No. 1 was Rs. 49,000, was more consistent with the relationship of master and servant or of principal and agent than with the relationship of partnership. We, on the other hand, feel that this provision is really and much more likely to exist where the contracting parties are entering into a partnership than in any other circumstances. In case of partnership where one of the partners has no capital to invest, he may be willing to agree that his share of the profits may accumulate in the firm and may be payable to him after the amount the amount had after equaled the amount invested by the financing partner. It is much more unlikely that any servant would agree that he should be paid no remuneration at all for his services for such a long period as seven years, or, that an agent would agree that he should not receive his commission for such a long period.

Reference was also made to paragraph 14 of the agreement deed which gave the powers to the two parties to ask for dissolution of the firm under ordinary circumstances. This paragraph reads as follows :-

"14. If party No. 1 does not wish to keep the partnership business then after giving one month's notice, the party No. 1 can close the shop and if the party No. 2 wants to separate from the partnership then the shop will not be closed and the party No. 2, after settling the dues and outstanding and after preparing the balance sheet whatever amount of his will be due after taking that or if any is to be taken from him and after paying that, he can separate from the business; for which a three months notice will be given to party No. 1."

This paragraph, as originally printed in the paper book prepared by the Department, had the words, "remove the party No. 2" in place of the words, "close the shop." In view of this word it had been argued by the learned counsel for the Department that this agreement obviously incorporated a contract of service and not of partnership because the power of removal of one party by another party is, in no way, consistent with partnership and can only be enforced under a contract of service or may be exercisable under a contract of agency. It was unfortunate that such an error was made in translating such an important document. We looked into the original agreement deed which is in Hindi and found that the translation contained a serious error. With the corrected translation the terms of this paragraph are entirely consistent with partnership. In this case, as has been mentioned above, party No. 1 was to continue to be the owner of the assets of the firm and was also to be the owner of the goodwill. Consequently, if party No. 1 wanted dissolution of partnership, he could have the option of closing down the shop at the same time. On the right given to party No. 2 on dissolution thereof was merely to separate by taking away his share of the profits without being entitled to insist of the closure of shop. The deed of agreement read as a whole clearly shows that this was an agreement of partnership and not one creating relationship of master and servant or of principal and agent between party No. 1 & party No. 2. Learned counsel for the Department relied on the case of *Walker v. Hirsch*, in support of his contention that the partnership agreement in this case should be construed as creating a contract of service. It, however, appears that that case proceeded on certain facts which have not been found to exist in the present case. In that case, the agreement between the plaintiff and the firm of H. & Co., had provided that the plaintiff should receive a fixed salary in addition to receiving one-eighth share of the net profits and bearing

one-eighth share of the losses. The plaintiff was further found to have been previously a clerk of the defendants who were the second contracting parties and he continued to perform the similar duties after the execution of the agreement and was not introduced to the customers as a member of the firm and did not sign the bills of the firm. Similar circumstance have not been found to exist in the present case by the Income-tax Appellate Tribunal. Learned counsel for the Department referred us to some facts found by the Income-Tax Officer and Appellate Assistant Commissioner of Income-tax who dealt with this case but we cannot take into account facts found by those two officers. In this reference we can only take notice of facts which have been stated by the Tribunal in their statement of the case and we possibly refer to the facts found by the Tribunal in their appellate judgment out of which this reference arose. In none of these documents were any facts found similar to those which existed in the case *Walker v. Hirsch*.

Under these circumstances, we hold that, on a correct construction of the deed of partnership dated the 3rd of April, 1944, a genuine partnership could be inferred. We answer the question accordingly. The assessee entitled to its cost from the Department which we assess at Rs. 150.

Reference answered accordingly.