Supreme Court of India
Commissioner Of Income-Tax And ... vs G. Parthasarthy Naidu And Ors. on 26 March, 1996
Equivalent citations: 1999 236 ITR 350 SC, (1998) 8 SCC 487
Bench: B J Reddy, S S Ahmad
JUDGMENT Civil Appeal No. 3054 of 1983 :

1. Though served, nobody appears for the respondents. This appeal is preferred against a decision of the Full Bench of the Andhra Pradesh High Court in CIT v. G. Parthasarathy Naidu and Sons . The question which was referred for the opinion of the High Court under Section 256(1) of the Income-tax Act, 1961 (page 99) "whether on the facts and in the circumstances of the case, G. Parthasarathy Naidu and Sons and Messrs. Sri Lakshmi Oil and Flour Mills can be treated as two separate firms and distinct assessable entities ?"

2. The Full Bench overruled an earlier decision of the same court in Addl. CIT v. M. Venkata Narasimha Rao and Co. . The Full Bench enunciated as many as ten principles as flowing from the several decisions considered by them. The ten principles stated (at pages 108-109 of 121 ITR) are as under :

(1) The concept of partnership law is that a firm is not an entity or a person in law but only a compendious mode of designating persons who have agreed to carry on business in partnership.

(2) A firm as such is not entitled to enter into partnership with another firm or individual as the definition of 'person' in Section 3(42) of the General Clauses Act, 1897, cannot be imported into Section 4 of the Indian Partnership Act.

(3) The law, English as well as Indian, has for some specific purposes, relaxed its rigid notions and extended a limited personality to a firm.

(4) Under the income-tax law a firm is an independent and distinct juristic person for the purpose of assessment as well as for recovery of tax as it is a 'person' within the meaning of Section 2(31) of the Act, having its own entity and personality. It is also a separate entity under the sales tax law.

(5) It is well settled that it is open to any person to arrange his or its affairs by adopting a legal device to reduce his or its tax liability to the minimum permissible under the law and such a device cannot be equated to an attempt to evade tax as long as his or its action is consistent but not contrary to law (see CIT v. Sivakasi Match Exporting Co.

(6) In law, there is no prohibition for the creation or existence of two or more separate firms or partnerships by the same partners.

(7) Whether a firm is genuine or bogus or benami is a pure question of fact. But whether two or more partnerships or firms constituted under different deeds of partnership are, in reality, only one partnership or not is a mixed question of fact and law.

(8) The prime guideline to determine this latter question is the cumulative effect or the totality of all the material factors relating to the object and intendment of the partnerships and businesses, their nature, character and identity, coupled with the factum or otherwise of interlacing and interlocking of funds between the two firms.

(9) The very question as to whether there was really one partnership or two different assessable entities being two separate distinct partnerships unconnected with each other, has to be determined by the income-tax authorities for the purpose of computing the assessment under the Income-tax Act but not under the general law governed by the provisions of the Partnership Act.

(10) The finding of the Tribunal about the object and intendment of the partnerships and the businesses and the factum or otherwise of the interlacing and interlocking of the funds between the two partnerships is a question of fact and such finding would be binding on the High Court in a reference unless there is no material in support of it.

3. So far as the facts of the case are concerned, the discussion in the Full Bench judgment is to the following effect (page 109) :

We may at this stage recapitulate the facts found or admitted by the Tribunal in this case on hand. Admittedly, the partners in both the firms are the same. Admittedly, each of the partners in both the firms shared 1/4 of the profit. However, the three major partners in the assessee-firm shared equally 1/3 of the loss, if any, whereas in the second firm, Sri Lakshmi Oil and Flour Mills, the loss was shared by G. Parthasarathy Naidu, Varaprasada Rao and Chandrasekhara Rao at half, 1/4 and 1/4, respectively. The business of the assessee-firm was to deal in pulses, whereas the business of Sri Lakshmi Oil and Flour Mills was to manufacture and sell groundnut oil and other oils, oil cake and to purchase and sell groundnut kernel, oils, oil cake and to work the oil mill and the flour mill. Paragraph 15 of the partnership deed of Sri Lakshmi Oil and Flour Mills makes it specific that the business of this partnership shall not be deemed as part and parcel of the assesses-partnership constituted under the deed of partnership dated October 1, 1968. This clause establishes that the intention of the partners in constituting the second firm was to make it a separate, distinct firm unconnected with the assessee-firm which had already come into existence on October 1, 1968. The registration under the Income-tax Act granted by the Income-tax Officer to Sri Lakshmi Oil and Flour Mills was not cancelled and the same was allowed to continue as a registered firm. The two firms had been constituted under two separate deeds of partnership. There was no interlacing or intermixing between the two firms. The Tribunal found that there was no justification for including the profit of Rs. 5,500 belonging to Sri Lakshmi Oil and Flour Mills in the income of the assessee-firm and consequently deleted the same.

Applying the aforesaid principles to the facts and circumstances found by the Tribunal, we must hold that the two firms in the instant case are not, in reality, one firm but two different legal entities for the purpose of assessment.

4. It is brought to our notice that the ratio of the Full Bench decision has been expressly disapproved by this Court in Deputy CST v. K. Keluhutty . It is, therefore, obvious that the ten principles

enunciated by the Full Bench have to be read subject to the decision of this Court, in K. Kelukutty's case . Now the ratio of the decision in K. Kelukutty's case is this (page 163) :

Now, in every case when the assessee professes that it is a partnership firm and claims to be taxed in that status, the first duty of the Assessing Officer is to determine whether it is, in law and in fact, a partnership firm. The definition in the tax law defines an 'assessee' or a 'dealer' as including a firm. But for determining whether there is a firm, the Assessing Officer will apply the partnership law, subject of course, to any specific provision in that regard in the tax law modifying the partnership law. If the tax law is silent, it is the partnership law only to which he will refer. Having decided the legal identity of the assessee that it is a partnership firm, he will then turn to the tax law and apply its relevant provisions for assessing the partnership income.

The Kerala General Sales Tax Act contains no provision which bears on the identity of a partnership firm. Therefore, recourse must be had for that purpose to the partnership law alone. Where it is claimed that there are not one but two partnership firms constituted by the same persons and carrying on different businesses, the assessing authority must test the claim in the light of the partnership law. It is only after that question has been first determined, namely, whether in law there is only one partnership firm or two partnership firms, that the next question arises : whether the turnover is assessable in the hands of the partnership firm as a taxable entity separate and distinct from the partners ? There is first a decision under the law of partnership ; therefore, the second question arises, the question as to assessment under the tax law. It is clear, therefore, that reference must be made first to the partnership law.

The Indian Partnership Act, 1932, has, by Section 4, defined a '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'. The section declares further that the persons who have entered into partnership with one another are called individually 'partners' and collectively 'a firm'. The components of the definition of 'partnership', and, therefore, of 'a firm' consist of (a) persons, (b) a business carried on by all of them or any of them acting for all, and (c) an agreement between those persons to carry on such business and to share its profits. It is the relationship between those persons which constitutes the partnership. The relation is founded in the agreement between them. The foundation of a partnership and, therefore, of a firm is a partnership agreement. A partnership agreement is the source of a partnership ; it also gives expression to the other ingredients defining the partnership, specifying the business agreed to be carried on, the persons who will actually carry on the business, the shares in which the profits will be divided, and several other considerations which constitute such an organic relationship. It is permissible to say that a partnership agreement creates and defines the relation of partnership and, therefore, identifies the firm. If that conclusion be right, it is only a further step to hold that each partnership agreement may constitute a distinct and separate partnership and, therefore, distinct and separate firms. That is not to say that a firm is a corporate entity or enjoys a juristic personality in that sense. The firm- name is only a collective name for the individual partners. But each partnership is a distinct relationship. The partners may be different and yet the nature of the business may be the same, the businesses may be different and yet the partners may be the same. An agreement between the partners to carry on a business and share its profits may be followed by a separate agreement between the same partners to carry on another

business and share the profits therein. The intention may be to constitute two separate partnerships and, therefore, two distinct firms. Or to extend merely a partnership originally constituted to carry on one business, to the carrying on of another business. It will all depend on the intention of the partners. The intention of the partners will have to be decided with reference to the terms of the agreement and all the surrounding circumstances, including evidence as to the interlacing or interlocking of management, finance and other incidents of the respective businesses.

5. Now let us see whether applying the ratio of K. Kelukutty's case , can it be said, in this case that the two partnerships are really one and the same and not two distinct partnerships. In the light of the facts found recorded in the judgment of the Full Bench, we are of the opinion that they were two distinct firms. The finding of the High Court is unexceptional and requires no interference in this appeal. Accordingly, while holding that the principles enunciated in the judgment under appeal cannot all of them be accepted as correct and must be read subject to and in the light of the decision of this Court in K. Kelukutty's case , the conclusion arrived at by the Full Bench on the facts of that case appears to be correct. Accordingly, this appeal is dismissed subject to the above observations and clarifications. There will be no order as to costs.

Civil Appeals Nos. 448-52 of 1984 :

6. These appeals are preferred against the judgment of the Karnataka High Court answering the following question in the negative :

Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that there were no two separate firms in law and the business of both GM and GFC have to be taken as belonging to the same four partners constituting a single firm ?

7. The assessment years concerned herein are 1965-66 to 1969-70. The question, in short, was whether the two firms-Greenline Motors and Greenline Finance Corporation-were two distinct firms, to be assessed separately as such or could they be considered as constituting one and a single firm and assessed as such. The Tribunal followed the decision of the Andhra Pradesh High Court in Addl. CIT v. M. Venkata Narasimha Rao and Co. , and upheld the Revenue's contention. When the matter came to the High Court, on reference, the High Court noticed that the decision of the Andhra Pradesh High Court in M. Venhata Narasimha Rao and Co. was overruled by the later Full Bench decision in CIT v. G. Parthasarathy Naidu and Sons . It followed the Full Bench of the Andhra Pradesh High Court aforesaid and held that the Tribunal was not right in making the order it did.

8. Today the situation is that the correct principles to be applied in this behalf have been authoritatively enunciated by this Court in K. Kelukutty's case . The ratio of the decision is to be found at pages 163-165. This decision was not available when the decision under appeal was rendered. In such a situation the proper course would be to set aside the judgment of the High Court and remit the matter back to the High Court for a decision afresh in the light of the principles enunciated by this Court in K. Kelukutty's case . There will be no order as to costs.

Civil Appeals Nos. 4693-95 of 1991 :

9. These appeals are allowed in the same terms as Civil Appeals Nos. 448-452 of 1984. The assessee is the same ; only the assessment years are different. No costs.