

## S. SANKAPPA AND OTHERS

v.

THE INCOME-TAX OFFICER, CENTRAL CIRCLE II,  
BANGALORE

December 14, 1967

[J. C. SHAH, V. RAMASWAMI AND V. BHARGAVA, JJ.]

*Income Tax Act, 1922, ss. 23, 35—Income Tax Act, 1961, ss. 155 297(2)(a)—Whether proceedings on issue of notice under s. 35(5) of the Act of 1922 for rectification are proceedings for assessment within the meaning of s. 297(2)(a) of the Act of 1961.*

During the assessment years 1958-59, 1959-60 and 1960-61, two firms in which the six appellants were partners, filed returns declaring themselves to be registered firms and also presented applications for registration of the firms under s. 26A of the Income-tax Act, 1922. The Income-tax Officer refused registration of the firms and assessed the income of the firms, treating them as unregistered. The assessments of the six appellants were also made, so that their incomes from the two firms were included in their individual assessments as if they had received the income in the capacity of partners in unregistered firms. Appeals made by the firms against the order refusing registration were allowed by the Appellate Assistant Commissioner and, in pursuance of the appellate orders, the Income Tax Officer passed a consolidated order on 20th December, 1966, revising the assessments of the firms for all these years on the basis that they were registered firms and also apportioned the income of the firms between the six partners. Subsequently, the Income Tax Officer issued notices under s. 155 of the Income Tax Act, 1961, proposing to rectify the individual assessments of the six appellants in respect of each of the three assessment years, whereupon the appellants challenged the validity of the notices by writ petitions. It was conceded before the High Court on behalf of the Income Tax Officer that as the rectification proposed related to assessment years when the Income Tax Act, 1922, was applicable, proceedings for rectification could not be taken under s. 155 of the 1961 Act but only under s. 35(5) of the 1922 Act in view of the provisions of s. 297(2)(a) of the Act of 1961. The High Court dismissed the petitions.

In appeal to this Court it was contended, *inter alia*, that proceedings for rectification under s. 35(5) of the Act of 1922 cannot be held to be proceedings for assessment within the meaning of that expression used in s. 297(2)(a) of the Act of 1961, and therefore under that provision of law, the Act of 1922 could not be resorted to by the Income-tax Officer in order to rectify the assessments of the appellant; that, in any case, the provisions of s. 35(5) of the Act of 1922 are not attracted, because proceedings under that section can only be taken when it is found on the assessment or reassessment of a firm that the share of the partner in the profit or loss of the firm has not been included in the assessment of the partner or, if included, is not correct; and, in the present cases, there was no assessment or reassessment of the firms when the Income-tax Officer, in pursuance of the appellate order, proceeded to pass orders rectifying the assessments of the firms under s. 35(1) of the Act of 1922; as there was no fresh computation of income the proceedings sought to be taken were not proceedings for assessment.

HELD : Dismissing the appeal :

- A** (1) the word "assessment" is used in the Income-tax Act in a number of provisions in a comprehensive sense and includes all proceedings, starting with the filing of the return or issue of notice and ending with determination of the tax payable by the assessee. When proceedings are taken for rectification of assessment to tax either under s. 35(1) or s. 35(5) of the Act of 1922, they must be held to be proceedings for assessment. In proceeding under those provisions, what the Income-tax Officer does is to correct errors in, or rectify orders of assessment made by him, and orders making such correction or rectifications are, therefore clearly part of the proceedings for assessment. [678 B, G-H]
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The orders passed under s. 35(1) by the Income-tax Officer on 20th December, 1966 were all orders altering assessment orders made in the proceedings for assessment of the firms, while under the impugned notices the Income-tax Officer was proposing to rectify orders made for computation of income and imposition of tax under the charging section in the case of individual partners. Clearly, therefore, in these cases, s. 297(2)(a) of the Act of 1961 permits the Income-tax Officer to proceed in accordance with the provisions of the Act of 1922 and he had rightly proposed to take action under s. 35(5) of the Act of 1922. [679 E-G]

- C** *Abraham v. Income-tax Officer*, 41 I.T.R. 425; *Kalawati Devi Harlalka v. The Commissioner of Income-tax, West Bengal & Ors*, Civil Appeal No. 1421 of 1966 decided on 1-5-1967, relied on.
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*M. M. Parikh, Income-tax, Officer, Special Investigation Circle "B" Ahmedabad v. Navanagar Transport and Industries Ltd. and Another*, 63 I.T.R. 663, distinguished.

- E** The provisions of s. 23 and other relevant sections of the Act of 1922 clearly show that proceedings for assessment of a firm consist of computation of the income of the firms, determination of tax payable by the firms, apportionment of the income of the firm between its partners in the case of a registered firm and, in appropriate cases, imposition of tax on the firm after including the share of the income of certain partners in the income of the firm, even though the firm is registered. The proceedings for assessment of the firm are not completed until all these steps have been taken by the Income-tax Officer, and each of those steps must be held to be a step in the proceedings for assessment of the firm. Consequently, when the Income-tax Officer passed the orders dated 20th December 1966 and apportioned the income of the firms between the various partners, the orders which he made were clearly orders in proceedings for assessment and it was in order to give effect to these orders in the individual assessment, of the partners that the impugned notices were issued. The first condition precedent that the proceedings under s. 35(4) are to be taken on the basis of information derived from orders of assessment or re-assessment of the firm was, thus clearly satisfied. [682 B-E]
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- G** *V. S. Arulanandam v. Income-tax Officer, Tuticorin*, 43 I.T.R. 511, at p. 517; distinguished.

The second condition precedent was also satisfied as the share of each partner in the profit or loss of the firm was not included in the assessment of the partner for the purpose of assessment of that share to tax. Inclusion contemplated by s. 35(5) is for assessment to tax of the share. In fact the inclusion was for the limited purposes of determining the exemption to which the partners were entitled under s. 14(2)(a) and for determining the rate of tax payable in the separate assessments under s. 16(1)(a). When the assessments of the unregistered firms were set aside, the individual partners ceased to be entitled to the benefit of

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s. 14(2)(a), and s. 16(1)(a) also become inapplicable. What was required to be done was to add the income of each partner in his individual assessment and then impose tax on it in accordance with s. 23(5)(a)(ii) of the Act of 1922. Thus, this was a clear case where the inclusion of the share of the income of the partner in his individual assessment was not correct. [683 F.H. 684 B-C]

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 1664 to 1681 of 1967.

Appeals from the judgment and order dated August 30, 31, 1967 of the Mysore High Court in Writ Petitions Nos. 354 to 371 of 1967.

*K. Srinivasan and R. Gopalakrishnan*, for the appellants (in all the appeals).

*C. K. Daphlary, Attorney-General, S. K. Aiyar and R. N. Sachithy*, for the respondent (in all the appeals).

The Judgment of the Court was delivered by

**Bhargava, J.** These eighteen appeals have been filed by six persons, some of whom were partners in a firm called "The Lalitha Silk Throwing Factory", some in another firm called "The Srinivasa Textiles", and some in both these firms. The appeals brought up to this Court under certificate granted by the High Court of Mysore are against the judgment of the High Court dismissing eighteen writ petitions by these six appellants praying for quashing notices issued by the Income-tax Officer, Bangalore, purporting to be under section 155 of the Income-tax Act No. 43 of 1961, proposing to rectify the assessments of the appellants in respect of the assessment years 1958-59, 1959-60 and 1960-61. Thus, the notices challenged are three notices for each of these assessment years in respect of each of the six appellants, so that there were 18 petitions before the High Court. The High Court decided all the petitions by a common judgment and, consequently in these appeals, all of them are being dealt with together.

During all these three assessment years 1958-59, 1959-60 and 1960-61, both the firms filed returns declaring themselves to be registered firms and also presented applications for registration of the firms under s. 26A of the Income-tax Act No. 11 of 1922. The Income-tax Officer refused registration of the firms and assessed the income of the firms, treating them as unregistered. The assessments of these six appellants were also made, so that their incomes from the two firms were included in their individual assessments as if they had received the income in the capacity of partners in unregistered firms. The firms went up in appeal against the orders of the Income-tax Officer refusing registration. These appeals were allowed by the Appellate Assistant Commis-

- A sioner by an order dated 26th November, 1966 in respect of the Lalitha Silk Throwing Factory, and 14th December, 1966 in respect of Srinivasa Textiles. The Income-tax Officer, in pursuance of the appellate order of the Assistant Commissioner, passed a consolidated order revising the assessments of the firms for all these years on the basis that they were registered firms and
- B also apportioned the income of the firms between these six partners. Subsequently, the notices impugned in these petitions were issued on 19th January, 1967, whereby the Income-tax Officer proposed to rectify the individual assessments of the six appellants in respect of each of the three years of assessment under section 155 of the Act of 1961. The appellants in the writ petitions
- C challenged the validity of these notices, but the High Court dismissed the writ petitions and, consequently, the appellants have come up in these appeals before us.

- It was conceded before the High Court on behalf of the Income tax Officer that proceedings for rectification of the assessments of the appellants could not be taken under s. 155 of the Act of 1961, because, admittedly, the rectifications related to assessments of
- D tax for assessment years when the Act of 1922 was applicable, so that proceedings could only be taken under s. 35(5) of the Act of 1922 in view of the provisions of s. 297(2)(a) of the Act of 1961. Before us, learned counsel for the appellants urged that proceedings for rectification under s. 35(5) of the Act of 1922 cannot be held to be proceedings for assessment within the mean-
- E ing of that expression used in s. 297(2)(a) of the Act of 1961, so that, under that provision of law, the Act of 1922 could not be resorted to by the Income-tax Officer in order to rectify the assessments of the appellants. On the same basis, it was further urged that, in any case, the provisions of s. 35(5) of the Act of 1922 are not attracted, because proceedings under that section can only
- F be taken when it is found on the assessment or reassessment of a firm that the share of the partner in the profit or loss of the firm has not been included in the assessment of the partner or, if included, is not correct; and, in the present cases, there was no assessment or reassessment of the firms when the Income-tax Officer, in pursuance of the order of the Appellate Assistant Commissioner
- G granting registration to the firms, proceeded to pass orders rectifying the assessments of the firms under s. 35(1) of the Act of 1922 on 20th December, 1966. It was urged that no fresh computation of income of the partners is sought to be made in pursuance of the notices issued and, similarly, no fresh computation of the income of the firms was made when the Income-tax Officer passed his orders on 20th December, 1966 to give effect to the decision
- H of the Appellate Assistant Commissioner granting registration to the firms. No fresh computation of income being involved, it must be held that the proceedings now sought to be taken are not

proceedings for assessment, and, similarly, no proceedings for assessment or reassessment were taken by the Income-tax Officer when he passed his orders on 20th December, 1966. This submission, in our opinion, has been rightly rejected by the High Court, because it has already been explained by this Court that the word "assessment" is used in the Income-tax Act in a number of provisions in a comprehensive sense and includes all proceedings, starting with the filing of the return or issue of notice and ending with determination of the tax payable by the assessee. Though in some sections, the word "assessment" is used only with reference to computation of income, in other sections it has the more comprehensive meaning mentioned by us above. Reference may be made to the decision of this Court in *Abraham v. Income-tax Officer*<sup>(1)</sup>. The same principle has been recently reiterated in the case of *Kuawati Devi Harlalka v. The Commissioner of Income-tax, West Bengal & Ors.*<sup>(2)</sup> where, dealing with the word "assessment" used in s. 297 of the Act of 1961, the Court held :—

"It is quite clear from the authorities cited above that the word 'assessment' can bear a very comprehensive meaning; it can comprehend the whole procedure for ascertaining and imposing liability upon the taxpayer. Is there then anything in the context of s. 297 which compels us to give to the expression 'procedure for the assessment' the narrower meaning suggested by the learned counsel for the appellant? In our view, the answer to this question must be in the negative. It seems to us that s. 297 is meant to provide as far as possible for all contingencies which may arise out of the repeal of the 1922 Act. It deals with pending appeals, revisions, etc. It deals with non-completed assessments pending at the commencement of the 1961 Act and assessments to be made after the commencement of the 1961 Act as a result of returns of income filed after the commencement of the 1961 Act."

It is clear that, when proceedings are taken for rectification of assessment to tax either under s. 35(1) or s. 35(5) of the Act of 1922, those proceedings must be held to be proceedings for assessment. In proceeding under those provisions, what the Income-tax Officer does is to correct errors in, or rectify orders of assessment made by him, and orders making such corrections or rectifications are, therefore, clearly part of the proceedings for assessment.

(1) 41 I.T.R. 425. (2) Civil Appeal No. 1421 of 1966 decided on 1.5.1967.

- A The main stay of the argument of learned counsel for the appellants against this view was the decision of this Court in *M. M. Parikh, Income-tax Officer, Special Investigation Circle "B", Ahmedabad v. Navanagar Transport and Industries Ltd. and Another*<sup>(1)</sup> in which case the Court was dealing with the question whether an order imposing additional super-tax under s. 23A of the Act of 1922 was an order of assessment and held to the contrary. The decision in that case does not, in our opinion, support the submission made on behalf of the appellants in the present cases. It was explained there that, under s. 23A of the Act of 1922, there was no computation of income or determination of tax imposed by the charging section. That section by itself empowered the Income-tax Officer to impose the super-tax by his own order, and an order imposing such a tax could not be held to be an order of assessment. Further examples of similar orders were cited in that case and reference was made to orders under ss. 18A(1), 35(9), 35(10) and 35(11) of the Act of 1922. After referring to these provisions, the Court clearly indicated the reason for holding that proceedings under those provisions were not proceedings for assessment of tax by stating :

"The salient feature of these and other orders is that the liability to pay tax arises not from the charge created by statute, but from the order of the Income-tax Officer."

- E In the present cases the orders, which have been rectified or are being taken up for rectification, are all orders under which there was assessment of incomes and determination of the charge to tax in accordance with the charging sections. The orders passed under s. 35(1) by the Income-tax Officer on 20th December, 1966 were all orders altering assessment orders made in the proceedings for assessment of the firms, while under the impugned notices
- F the Income-tax Officer is proposing to rectify orders made for computation of income and imposition of tax under the charging section in the case of individual partners. Clearly, therefore, in these cases, s. 297(2)(a) of the Act of 1961 permits the Income-tax Officer to proceed in accordance with the provisions of the Act of 1922 and he has rightly proposed to take action under
- G s. 35(5) of the Act of 1922 on the basis of rectifications made in the assessments of the firms under s. 35(1) of that Act on 20th December, 1966 in pursuance of the appellate orders granting registration to the firms.

- H The second point raised by learned counsel was that, in any case, the orders actually made by the Income-tax Officer on 20th December, 1966 in the cases of these firms cannot be held to be orders of assessment, because all that the Income-tax Officer did

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(1) 63 I.T.R. 663.

and was required to do in order to give effect to the orders of the Appellate Assistant Commissioner granting registration was to re-calculate the tax payable by the firms under s. 23(5)(a) of the Act of 1922, and such an order would not be an order of assessment at all. Copies of the orders actually passed by the Income-tax Officer under s. 35(1) in the cases of both the firms have been produced before us. They show that the orders consist of two parts. In the first part, the tax payable by the firms was re-calculated on the basis that the firms were registered firms and refund was allowed, because a larger amount of tax had been assessed and realised, treating the firms as unregistered. In the second part, the share income of the assessee firms was allocated between the various partners. It appears to us that this composite order re-determining the tax payable by the firms directing refund and apportioning the income of the firms between the partners can be held to be nothing other than an order made in proceedings for assessment of the firms.

Under the Act of 1922, the assessment of a firm is made under s. 23(5) which is as follows :—

“23(5). Notwithstanding anything contained in the foregoing sub-sections, when the assessee is a firm and the total income of the firm has been assessed under sub-section (1), sub-section (3) or sub-section (4), as the case may be,—

- (a) in the case of a registered firm,
  - (i) the income-tax payable by the firm itself shall be determined; and
  - (ii) the total income of each partner of the firm, including therein his share of its income, profits and gains of the previous year, shall be assessed and the sum payable by him on the basis of such assessment shall be determined :

Provided that if such share of any partner is a loss it shall be set off against his other income or carried forward and set off in accordance with the provisions of section 24 :

Provided further that when any of such partners is a person not resident in the taxable territories, his share of the income, profits and gains of the firm shall be assessed on the firm at the rates which would be applicable if it were assessed on him personally, and the sum so determined as payable shall be paid by the firm;

**A** Provided also that if at the time of assessment of any partner of a registered firm, the Income-tax Officer is of opinion that the partner is residing in Pakistan, the partner's share of the income, profits and gains of the firm shall be assessed on the firm in the manner laid down in the preceding proviso and the sum so determined as payable shall be paid by the firm; and

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**C** (b) in the case of an unregistered firm, the Income-tax Officer may, instead of determining the sum payable by the firm itself, proceed to assess the total income of each partner of the firm, including therein, his share of its income, profits and gains of the previous year, and determine the tax payable by each partner on the basis of such assessment, if, in the Income-tax Officer's opinion, the aggregate amount of the tax including super-tax, if any, payable by the partners under such procedure would be greater than the aggregate amount which would be payable by the firm and the partners individually, if separately assessed; and where the procedure specified in this clause is applied to any unregistered firm, the provisos to clause (a) of this sub-section shall apply thereto as they apply in the case of a registered firm."

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**E** It will be noticed that, under this provision, various orders have to be made by the Income-tax Officer. In the case of a registered firm, the Income-tax Officer, after computing the income, has to determine the tax payable by the firm itself, and provision is made that, thereafter, the share in the income of the firm of each partner is to be included in his total income for purposes of his individual assessment to tax. It is true that the Income-tax

**F** Officer assessing the firm may not be the same Officer who may be dealing with the individual assessment of the partners and, in any case, even if he be the same Officer, the proceeding for assessment of the partners has to be treated as a separate proceeding; but it is also clear that the proceedings for assessment of the firm under this section do not come to an end merely on computation of the income of the firm and determination of the tax payable by the firm on that income. The Income-tax Officer, who deals with the assessment of the firm, has also to apportion the income of the firm, in the case of a registered firm, between its partners and the notice of that apportionment has to be given under s. 23(6) by him to the firm. This apportionment is clearly treated as a part of the proceeding for assessment of the firm and that is why the notice is to be given to the firm. The second proviso to s. 30(1) also clarifies this position by laying down that the right of appeal in respect of the apportionment is to be exercised by the

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partners by filing appeals against the order of assessment of the firm and not against orders made in the course of subsequent proceedings for the individual assessments of the partners themselves. The second proviso to s. 23(5)(a) also brings out this position. In certain cases, after the apportionment of the income of the registered firm, the share of a particular partner, who is not resident in the taxable territories, is to be assessed to tax also as if it is the income of the registered firm. All these provisions clearly show that proceedings for assessment of a firm consist of computation of the income of the firm, determination of tax payable by the firm, apportionment of the income of the firm between its partners in the case of a registered firm and, in appropriate cases, imposition of tax on the firm after including the share of the income of certain partners in the income of the firm, even though the firm is registered. The proceedings for assessment of the firm are not completed until all these steps have been taken by the Income-tax Officer, and each one of those steps must be held to be a step in the proceedings for assessment of the firm. Consequently, when the Income-tax Officer passed the orders dated 20th December, 1966 and apportioned the income of the firms between the various partners, the orders which he made were clearly orders in proceedings for assessment and it was in order to give effect to these orders in the individual assessment of the partners that the impugned notices were issued. The first condition precedent that the proceedings under s. 35(5) are to be taken on the basis of information derived from orders of assessment or re-assessment of the firm was, thus, clearly satisfied.

In this connection, learned counsel drew our attention to a decision of the Madras High Court in *V. S. Arulanandam v. Income-tax Officer, Tuticorin*<sup>(1)</sup>, where that Court, dealing with section 35(5) of the Act of 1922, held :—

“The respondent relied at one stage on section 35(5) of the Act. It should be obvious that the petitioner's case did not come within the scope of section 35(5). There was no reassessment of the income of the firm; nor was there an appeal against the assessment of the firm. The only appeal of the firm was against the order of the Income-tax Officer refusing registration under section 26A. In fact, the finality of the assessment of the firm dated November 11, 1954, was left untouched all through, an aspect to which we shall have to advert again.”

Reliance was placed on this comment, because in that case also the firm, of which the assessee was a partner, was first refused

(1) 43 I.T.R. 511, at p. 517.

- A registration and the assessment of the partner was sought to be rectified when, subsequently, registration of the firm was allowed. The facts of that case were, however, different. In that case, there was no assessment or reassessment of the firm subsequent to the grant of registration. The petition filed by the assessee in the High Court under Art. 226 of the Constitution against proceedings of rectification sought to be taken by the Income-tax Officer was allowed on two grounds. One was that the Income-tax Officer had given no opportunity to the assessee before completing the proceedings of rectification under s. 35. The other was that the income of the firm had already been taxed as the income of the unregistered firm and there could be no second assessment of the same income in respect of the assessee's share in his assessment until the assessment of that income to tax in the hands of the firm was set aside. What was thus set aside was the attempt to tax the same income twice. It was in these circumstances that the Court observed that there was no scope for the applicability of s. 35(1) or s. 35(5) of the Act of 1922. Section 35(5) did not apply, because, in fact, there was no assessment or reassessment of the income of the firm subsequent to the order granting registration. The finality of the assessment of the firm had been left untouched and while that order remained intact, the provisions of s. 35(5) could not possibly be attracted. In the case before us, after registration of the firms was allowed in appeal, the Income-tax Officer in the proceedings for assessment of the firms proceeded further to make a fresh assessment of the tax payable by the firms and also to apportion the income of the firms between various partners, so that the income of the firms no longer remained taxed as income of unregistered firms, and liability arose of the partners to be taxed in their assessments in respect of their shares of the income. Clearly, in these circumstances, s. 35(5) was rightly applied.

- The last point urged by learned counsel was that, in s. 35(5) of the Act of 1922, there is a second condition precedent, on the existence of which alone proceedings for rectification can be taken under it and that condition is that it should be found that the share of the partner in the profit or loss of the firm had not been included in the assessment of the partner, or, if included, was not correct; and there was no such finding in the present cases. The share of each partner was not included for the purpose of assessment of that share to tax. Inclusion contemplated by s. 35(5) is for assessment to tax of the share. The inclusion was for only two limited purposes. One purpose was of determining the exemption to which the partners were entitled under s. 14(2)(a) of the Act of 1922. The other purpose was for determining the rate at which tax was payable in the separate assessments of the partners under s. 16(1)(a) of

that Act. The shares of the income of the partners were never included for the purpose of bringing those shares of income to tax in their individual assessments. The tax was actually imposed in the assessment of the firms themselves treating it as the income of unregistered firms. When the assessments of the unregistered firms were set aside, the individual partners ceased to be entitled to the benefit of s. 14(2)(a), and s. 16(1)(a) also became inapplicable. What was required to be done was to add the income of each partner in his individual assessment and then impose tax on it in accordance with s. 23(5)(a)(ii) of the Act of 1922. Thus, this was a clear case where the inclusion of the share of the income of the partner in his individual assessment was not correct. If the submission made on behalf of the appellants be accepted, a curious result would ensue, because the liability of the firms to pay tax on the basis that they were unregistered firms would stand vacated, while the shares of the partners in the firms would not be brought to tax in their individual assessments under s. 23(5)(a)(ii), so that the income would escape charge to tax altogether. It is clear that s. 35(5) of the Act of 1922 is enacted precisely to meet situations of the type that has come up in the present cases, so that when the imposition of the tax on the firm as an unregistered firm is set aside, tax can be imposed on the shares of the income of the partners in their individual assessments by rectifying them under s. 35(5) of the Act of 1922. This submission, consequently, has no force.

The appeals fail and are dismissed with costs. There shall be one hearing fee.

R.K.P.S.

*Appeals dismissed.*