Additional Commissioner of Income-Tax

Vs

Degaon Ganga Reddy G. Ramakrishna and Co. and Others

Civil Appeal No. 222 of 1977

(K. S. Paripoornan, J. S. Verma JJ)

01.03.1995

JUDGMENT

J. S. VERMA J. -

This appeal is by a certificate granted by the Andhra Pradesh High Court on the question as to "whether a sub-partnership which is alleged to be illegal as being in violation of section 14 of the A.P. (Telangana Area) Abkari Act, 1316F, can be registered under the income-tax Act". The impugned judgment of the High Court is Addl. CIT v. Degaon Gangareddy G. Ramkishan and Co. [1978] 111 ITR 93. The decision of the High Court was rendered in a reference made by the Income-tax Appellate Tribunal, Hyderabad Bench, under section 256(1) of the Income-tax Act, 1961, at the instance of the Revenue for opinion on the following question of law, namely (at page 96) :

> "Whether, on the facts and in the circumstances of the case, the sub- partnerships are entitled to the benefits of registration under the Income-tax Act, 1961, for the assessment year 1964-65 ?"

The High Court answered the question in the affirmative, in favour of the assessee and against the Revenue. Hence, this appeal by the Revenue on a certificate granted by the High Court.

The material facts are : For the relevant assessment year, a partnership by name "Nizamabad Group Sendhi Contractors" was formed under a deed of partnership dated October 15, 1962, with 17 partners, one of whom, Rampuram Ganga Goud, had a ten per cent. share. On August 27, 1963, Ganga Goud and 11 others executed a partnership deed to the effect that Ganga Goud, after becoming a partner in Nizamabad Sendhi Group Contractors, the main partnership, found it difficult to contribute the required capital towards his share and, therefore, the other 11 partners of the sub-partnership agreed to provide the finance on their being taken as partners in respect of Ganga Goud's 10 per cent. share in the main partnership. The main partnership, that is, Nizamabad Sendhi Group Contractors, are the lessees who were the highest bidders in the auction held by the excise authorities for the Fasli year 1962-63. The main partnership has been registered by the Income-tax Department under the Income-tax Act. The partners of the sub-partnership filed an application for its registration as a firm under the Income-tax Act on September 30, 1963. The Income-tax Officer rejected the claim of the sub-partnership for registration under the Income-tax Act on the ground that no business was conducted by the assessee during the relevant year of account and that the sub-partnership was void ab initio under the Andhra Pradesh (Telangana Area) Abkari Act (hereinafter referred to as "the Abkari Act") as the members of the sub-partnership except Ganga Goud were not licenceholders under the Abkari Act. On appeal, the Appellate Assistant Commissioner upheld the

order of the assessing authority taking the view that registration of the sub-partnership would defeat the purpose of the Abkari Act. Similar applications for registration under the Income-tax Act by six other sub-partnerships formed by different partners of the main partnership with others were rejected by the assessing authority and their appeals were also dismissed by the Appellate Assistant Commissioner. All these seven sub-partnerships preferred further appeals to the Income-tax Appellate Tribunal. On a construction of the terms of the deed constituting the sub- partnerships, the Tribunal held that it could not be said that the sub-partnerships did not carry on any business; and that the sub- partnerships are separate entities valid in law. Accordingly, the Tribunal allowed the assessees' appeals and held that all the sub- partnerships were entitled to registration under the Income-tax Act.

Aggrieved by the decision of the Tribunal, the Revenue obtained a reference under section 256(1) of the Income-tax Act; 1961, in all the matters for the decision of the aforesaid common question of law which arose out of the Tribunal's order. The High Court upheld the Tribunal's view and has answered the said question against the Revenue and in favour of the assessee.

The High Court referred to the decision of this court in Murlidhar Himatsingka v. CIT [1966] 62 ITR 323 (SC), and stated thus (at page 101) :

> "This decision is an authority for the proposition that a valid sub- partnership can be entered into by a partner of the main firm with some strangers to share the income or loss receivable by him from the main partnership and a sub-partner has definite enforceable rights to claim a share in the profits accrued to or received by the partner in the original partnership, and such sub-partnership is entitled to registration and it creates a superior title and diverts the income from the main firm before it becomes the income of the partner."

This proposition is not doubted. The High Court then proceeded to consider the next question, namely, whether a partner of the main firm who deals in liquor. . . . or any other prohibited article which requires a specific permission of the State Government. . . . can validly enter into a sub-partnership with strangers in respect of his share in the main partnership. This question arises because of the prohibition contained in section 14 of the Abkari Act against carrying on business in liquor without a licence granted for the purpose. The High Court rightly pointed out that the partners of the sub- partnership would not become partners of the main partnership-firm and this position would not be altered in any manner even if the business of the main firm were to deal in liquor or any other prohibited article since the partners of the sub-partnership would be entitled only to share the profits and losses, as the case may be, that accrue or fall to the share of the partner in the main firm. Accordingly, the members of the sub-partnership do not become partners of the main firm, the two being different and distinct entities for the purpose of the Income-tax Act. The High Court, then proceeded to state thus (at page 105) :

> "All the decisions relied upon by the Revenue are applicable only if it is found as a fact that the sub-partnership had carried on the business of liquor, tobacco, opium or any other prohibited article without the requisite permission of the State Government or the Collector, as the case may be. . . . The pertinent question that arises in the present case is whether the sub-partnership has intended to do and in fact did business in liquor in the accounting year. If the sub-partnership also had indulged in the business of liquor without the requisite licence in the name of the sub-partnership or in the names of all the partners of the sub-partnership, the sub- partnership, on the

> application of the principles referred to above, must be held to be void ab initio and non est as it intended to do business in liquor without the requisite licence. If, on the other hand, the business of the sub-partnership is not the sale of liquor or dealing in liquor or doing anything in connection with the purchase and sale of liquor in any manner, it cannot be said that those sub- partnerships are illegal and void and non est. . . ."

After correctly stating the legal position, the High Court referred to the contents of the deed of sub-partnership and the finding of the Tribunal that the assessee-sub-partnership cannot be said to have not carried on any business; that the sub-partnership had financed and owned the capital invested by one of its partners in the main firm; and that the sub-partnership had been formed mainly to finance the business of one of the partners of the main firm doing abkari business and share the profits and losses accruing to or received by him from the main firm. The High Court also observed that the sub-partnership confined its business to only sharing the profits earned by one of the partners of the main partnership doing abkari business in lieu of their capital invested for the share of that partner and, therefore, it cannot be said that such a sub-partnership is prohibited in law. The decisions relied on by the Revenue were distinguished by the High Court on the facts since they related to partnerships formed for carrying on business in prohibited articles without the grant of a licence in favour of that partnership. The High Court also relied on the decision of this court in Jer and Co. v. CIT [1971] 79 ITR 546 (SC), wherein it was held that in the absence of a prohibition against the holder of a licence in liquor entering into a partnership, the partnership between the holder of the licence and some others was legal and entitled to registration under the Income-tax Act. In the absence of a specific prohibition against the entering into partnership even though transfer and subletting of the licence was prohibited, it was held that the partnership was valid and entitled to registration.

In bur opinion, the High Court was right in taking this view. Section 14 of the Andhra Pradesh (Telangana Area) Abkari Act, 1316F, reads as under :

> "14. Lessee not to declare any person to be his partner. - No lessee shall, except with the permission of the Government, declare any person to be his partner; and such partner shall not be competent to act as such until he has obtained a licence to that effect from the Collector or any other competent officer."

In view of the clear findings of fact recorded by the Tribunal, there can be no doubt that the sub-partnerships formed by individual partners of the main partnership which were lessees, with some others, merely to finance the business of a partner of the main firm doing abkari business and share the profits and losses accrued to or received by him from the main firm, were not in violation of section 14 of the Abkari Act. For this reason, there is no basis to hold that the sub-partnerships were in violation of section 14 of the Abkari Act and, therefore, illegal. The Tribunal was right in holding that in the facts and circumstances of the case, the assessee-sub-partnerships being found to be genuine were entitled to be registered under the Income-tax Act. The High Court has correctly answered the question of law referred to it, against the Revenue and in favour of the assessee.

Consequently, the appeals fail and are dismissed with costs quantified at Rs. 5,000.

</html