

Biharilal Jaiswal Etc.

Vs

Commissioner of Income Tax.

Civil Appeal Nos. 1825 to 1828 of 1977

(B. K. Kirpal, B. P. Jeevan Reddy JJ)

16.11.1995

JUDGMENT

B. P. JEEVAN REDDY, J. :

These appeals are preferred against the judgment and order of the Madhya Pradesh High Court rejecting the applications filed by the assessee under s. 256(2) of the IT Act, 1961. The assessee had requested the High Court to direct the Tribunal to state the following question of law for its opinion :

"Whether, on the facts and in the circumstances of the case, the applicant could be refused registration under s. 185 of the IT Act, 1961 on the ground that its constitution was illegal for breach of the provisions of cl. VI of the General Licence Conditions made under the Excise Rules, although no action was taken by the Collector for cancellation of the licence under cl. 14 of the Licence in Form CS-3, in spite of written intimation, dt. 27th April, 1967 about its constitution?"

The High Court rejected the applications on the ground that the question sought to be raised by the assessee was concluded against it by two decisions of that Court, viz., CIT vs. Sheonarayan Harnarayan (1973) Tax LR 1186 : (1975) 100 ITR 213 (MP) and CIT vs. Pagoda Hotel & Restaurant (1974) 93 ITR 271 (MP).

2. A licence for retail sale of country spirit under supply system in Form CS No. 3 of the Madhya Pradesh Excise Rules, 1960 was obtained by Biharilal Jaiswal in respect of twenty two out-stall shops in Tehsil Sarangarh, District Raigarh in the public auction held in January, 1968. The licence was effective for the period commencing on 1st April, 1968 and ending with 31st March, 1969. Biharilal Jaiswal entered into a partnership with ten other persons to conduct the business under the said licence. The partnership is evidenced by the deed dt. 30th Aug., 1968. An application for grant of registration to the said firm under ss. 184 and 185 of the Act was filed in Form 11. The ITO rejected the application for registration on the ground that the partnership having been formed in violation of cl. (VI) of the General Licence Conditions prescribed by the Madhya Pradesh Excise Rules is illegal and cannot, therefore, claim registration under the IT Act. On appeal, the AAC directed the ITO to grant registration as prayed for, against which order the Revenue appealed to the Tribunal. The Tribunal reversed the order of the AAC and restored the order of the ITO. Thereupon, the assessee applied to the Tribunal to refer two questions under s. 256(1) of the Act which was refused. The application to the High Court under s. 256(2) to refer the aforesaid (consolidated) question was also rejected, as stated above.

3. Clause (VI) of the General Licence conditions prescribed by the Excise Rules reads thus :

"VI. Transfer or sublease of licence : No privilege of supply or sale shall be sold, transferred or sub-leased, nor shall a holder of any such privilege enter into a partnership for the working of such privilege in any way or manner without the written permission of the Collector, which shall be endorsed on the licence. A partner, sub- lessee, transferee shall be bound by all the conditions of the licence, but the original licensee also shall continue to be responsible to the State Government for the due payment of the licence fees and proper working of the shop, except that in the case of a transfer his responsibility shall cease as soon as the transfer is endorsed on the licence."

Another condition of licence, viz., cl. (14) provided that "on breach of any of the conditions of this licence or of any of the provisions of the Madhya Pradesh Excise Act, 1915, or the Rules made thereunder, this licence may be cancelled by the Collector."

A few clauses in the partnership deed may also be noticed. The preamble to the partnership deed reads :

"Whereas Shri Girdharilal son of Buddhulal Jaiswal of Ambikapur has secured the excise contract of two liquor shops Goda Chawk and Talaiya in Bhopal in Sehore District for Rs. 3,05,000.00 and 1,50,000.00 respectively total of Rs. 4,55,000.00 in his name in the open auction held on 31st Jan., 1968 for the period from 1st April, 1968 to 31st March, 1969 and whereas as agreed between the aforesaid persons and as he alone unable to execute the same contract individually for want of funds and whereas the parties No. 1 to 8 named above having agreed to carry on the above contract business in partnership w.e.f. 1st April, 1968 desire to reduce in writing and place in a legal form the terms and conditions under which they have agreed to carry on the partnership business, they do hereby declare and stipulate that they have been partners in the firm named and styled as Girdharilal Jaiswal Liquor Contractor, Bhopal on the terms and conditions as detailed below :"

Clause (7) of the partnership deed provided that :

"No partner shall be entitled to any remuneration for taking part in the conduct of the firms and that all the partners shall carry on the same to the common advantage, be just and faithful to each other and shall render the accounts and full information of all things effective the firms business."

4. In Pagoda Hotel & Restaurant, (supra) a Division Bench of the Madhya Pradesh High Court had opined that the prohibition contained in cl. (VI) of the General Licence Conditions is absolute and couched in wide terms. Since the said clause expressly prohibited the entering into partnership for working the business/privilege under the licence, it was held, no partnership could have been entered into with respect to the said business. Accordingly, it was held that no registration can be granted under s. 26A of the Indian IT Act, 1922 to such an invalid partnership. The High Court distinguished the decisions of the Bombay and Patna High Courts in Champsey vs. Gordhandas AIR 1917 Bom 259, CIT vs. Prakash Ram Gupta (1969) 72 ITR 366 (Pat) and CIT vs. N. C. Mandal & Co. (1969) 72 ITR 769 (Pat) on the ground that the statutory provisions concerned in those cases merely prohibited the transfer of the privilege but did not contain a prohibition against entering into

partnership whereas the Madhya Pradesh Rules expressly prohibited the entering into partnership as well. This decision was followed in Sheonarayan Harnarayan (supra). The Division Bench rejected the contention put forward by the assessee that the decision in Pagoda Hotel & Restaurant (supra) must be deemed to have been overruled by the decision of this Court in Jer & Co. vs. CIT (1971) 79 ITR 546 (SC). The High Court pointed out that the statutory provision concerned in Jer & Co. (supra) was altogether different from the one contained in the Madhya Pradesh Excise Rules. The correctness of the said decisions, which have been followed in the order under appeal, are questioned in these appeals.

5. Sub-s. (1) of s. 184 (the other sub-sections being not relevant for the present purpose are not referred to) read as follows at the relevant time :

"184. Application for registration - (1) An application for registration of a firm for the purposes of this Act may be made to the ITO on behalf of any firm, if -

(i) the partnership is evidenced by an instrument; and

(ii) the individual shares of the partners are specified in that instrument." Sub-s. (1) of s. 185, which too is relevant for our purpose, read thus at the relevant time :

"185. Procedure on receipt of application. - (1) On receipt of an application for the registration of a firm, the ITO shall inquire into the genuineness of the firm and its constitution as specified in the instrument of partnership, and -

(a) if he is satisfied that there is or was during the previous year in existence a genuine firm with the constitution so specified, he shall pass an order in writing registering the firm for the assessment year,

(b) if he is not so satisfied, he shall pass an order in writing refusing to register the firm."

6. The position emerging from the above two sub-sections is this : an application for registration of a firm for the purposes of the Act could be made on behalf of any firm if the partnership was evidenced by instrument and that instrument specified the individual shares of the partners. On such application being filed, the ITO was obliged to enquire into the genuineness of the firm and its constitution as specified in the instrument of partnership and if, on such enquiry, he was satisfied that a genuine firm with the constitution as specified in the instrument of partnership was in existence during the relevant previous year, he was obliged to grant registration. If, however, he was not so satisfied, he was to reject the application. \*

\*An explanation was added to sub-s. (1) of s. 185 by the Taxation Laws (Amendment) Act, 1970 w.e.f. 1st April, 1971, which reads thus :

"Explanation. - For the purposes of this section and

s. 186, a firm shall not be regarded as a genuine firm if any partner of the firm was, in relation to the whole or any part of his share in the income or property of the firm, at any time during the previous year, a benamidar of any other person to whom the first mentioned partner does not stand in the relationship of a spouse or minor child".

Though this Explanation was not there during the assessment year concerned herein, it is yet indicative of Parliament's thinking. The Explanation frowned upon benami partners. It declared that existence of a benami partner renders the partnership not genuine within the meaning of s. 185(1), unless, of course, such benami partner happened to be the spouse or minor child. The said Explanation was substituted by a more elaborate one w.e.f. 1st April, 1976 by the Taxation Laws (Amendment) Act, 1975. We need not refer to it for the purpose of this case, since it merely elucidates the pre-existing Explanation.

7. In the present case, the partnership was evidenced by an instrument of partnership which specified the individual shares of the partners. The truth of the partnership agreement was not disputed by the Revenue nor was it disputed that the partners as specified in the instrument of partnership did the business under the excise licence for the relevant excise year/financial year. It is equally not in dispute that the written permission of the Collector was not obtained for entering into such partnership, though the assessee says that they had applied for the same. The only question is whether such a partnership could not be called a genuine partnership and whether such a partnership was disentitled to registration under the Act because of the fact that it was entered into without obtaining the written permission of the Collector. In other words, the question is whether a partnership which is prohibited by the law governing the licence and the business under the licence can yet be granted registration under IT Act. We have set out hereinbefore cl. (VI) of the General Conditions of the Licence. It provided that (a) the privilege of supply or sale granted to the licensee shall not be sold, transferred or sub-leased without the written permission of the Collector which shall be endorsed on the licence, (b) the holder of such licence/privilege shall not enter into a partnership for the working of such privilege in any way or manner without the written permission of the Collector which shall be endorsed on the licence, and (c) a partner, sub-lessee or a transferee shall be bound by all the conditions of licence but that did not mean that the original licensee was free of any obligations under the licence. The original licensee continued to be responsible to the State Government for the due payment of the licence fees and proper working of the shops except in the case of a transfer of licence in which case the responsibility of the original licensee ceased as soon as the transfer was endorsed on the licence. Clause (14) of the licence further provided that on breach of any of the conditions of licence or any of the provisions of the Madhya Pradesh Excise Act or the Rules made thereunder, the licence may be cancelled by the Collector.

8. The contention of Sri Pramod Swarup, learned counsel for the appellant, is that the prohibition contained in cl. (VI) of the General Licence Conditions provided by the Madhya Pradesh Excise Rules has no relevance in the matter of grant of registration under ss. 184 and 185 of the IT Act. May be, the learned counsel says, the said partnership would not be recognised by, and may not be able to enforce any of their rights against, the Excise Department but so far as the IT Act is concerned, such a partnership existed in fact and did actually do the business during the relevant previous year. In other words, the learned counsel says, the partnership was a genuine partnership. It was evidenced by an instrument of partnership specifying the individual shares of the partners and, therefore, entitled to grant of registration. The learned counsel for the Revenue, on the other hand, submits that since the excise law in force in Madhya Pradesh at the relevant time prohibited the entering into of partnership for the working of the privilege granted under the licence without the written permission of the Collector, no such partnership can be recognised in law. What is prohibited by one enactment cannot be recognised or sanctioned by another enactment. This should be so, he says, even if the enactment prohibiting the partnership is a State enactment and the Act whereunder registration is sought is a Parliamentary enactment; otherwise, it would be opposed to public policy. The learned counsel submits that an illegal partnership cannot be characterised as a genuine partnership within the meaning of s. 185(1). Sec. 23 of the Contract Act, the learned

counsel points out, declares that every agreement of which the object or consideration is unlawful is void. [Sec. 23 provides, inter alia, that where "the object of an agreement is..... of such a nature that if permitted, it would defeat the provisions of any law", it is an unlawful agreement and accordingly void]. The IT Act cannot sanction, recognise or grant registration to such a partnership agreement, he says.

9. The question concerned herein has been the subject-matter of consideration by this Court as well as several High Courts in the country. We shall first refer to the decisions of this Court. In *Umacharan Shaw & Bros. vs. CIT* (1959) 37 ITR 271 (SC), the question arose with reference to s. 26A of the Indian IT Act, 1922. Sec. 42(1)(a) of the Bengal Excise Act provided that "subject to such restrictions as the State Government may prescribe, the authority who granted any licence, permit or pass under this Act may cancel or suspend it... (a) if it is transferred or sub-let by the holder thereof without the permission of the said authority. The Tribunal had, of course, denied the registration not on the ground of illegality of partnership but on the ground that a genuine partnership had not come into existence. Even so, this Court referred to the said provision of the Bengal Excise Act and observed, "(T) here was no evidence that the excise licences were transferred or sub-let. The three shops, it appears, were managed separately and their accounts were kept distinct. There was thus nothing which militated against the partnership and it cannot be said that this affected the genuineness of the agreement". Having thus observed, this Court went into the material relevant on the question of genuineness of the partnership and held that there was no material upon which the ITO could come to the conclusion that the firm was not genuine. We may mention that this decision is not really relevant on the question arising in these appeals, yet we have referred to it because it happened to be the first decision relied upon by the learned counsel for the assessee- appellant.

The next decision relied upon is in *Jer & Co.* (supra). It was a case of the licensee entering into a partnership with others for doing the business under the licence. Though the High Court had proceeded on the footing that the excise licence concerned therein was governed by r. 322, which prohibited the holder of the licence from entering into a partnership with another person, this Court found, as a matter of fact, that the licence concerned therein was not governed by r. 322 but by a different rule in the Uttar Pradesh Excise Rules. The licence was issued in Form FL-II. It did not prohibit the licensee from entering into partnership with respect to the business under the licence. It merely provided that the licensee shall not sub-let or transfer the licence. In this view of the matter, this Court held that the question whether the partnership was illegal did not arise in that case and the firm was entitled to registration. This is what the Court said :

"The CIT and the High Court proceeded on the footing that the licence was governed by r. 322 which prohibited the holder of the licence from entering into a partnership with another person. But the licence, it is clear from the record, was in Form FL-II issued under the U. P. Excise Manual. The licence does not prohibit the holder from entering into partnership by the holder of the licence; it merely provides that the licence shall not be sub-let or transferred. Since there is no prohibition against entry by the holder of the licence into a partnership the question whether the partnership was illegal does not arise. The firm was entitled on that account to registration. It is somewhat unfortunate that the attention of the CIT and the High Court was not invited to the form in which the licence was issued by the excise authorities. They proceeded to decide the case on the footing that r. 322 of the Excise Manual applied. But that rule has no application here."

The learned counsel for the Revenue understands the said decision as laying down that a partnership prohibited by the excise law cannot be granted registration under the IT Act, while the learned counsel for the assessee reads it differently. Be that as it may, the fact remains that the rule concerned in the said decision did not prohibit entering into partnership by the licensee with respect to the business under the licence. It was for the said reason, this Court held that the partnership cannot be called illegal and cannot be refused registration., So far as the High Courts are concerned, their decisions turned upon the particular language of the statutory provisions concerned in each case. Several of these decisions have been referred to in an exhaustive decision of the Andhra Pradesh High Court in CIT vs. Nalli Venkataramana & Ors. (1984) 145 ITR 759 (AP) rendered with reference to Andhra Pradesh Excise Rules. Rule 19(1) of the Andhra Pradesh Excise Rules, 1969 provided that "(i) the licensee shall not transfer the licence for the sale of arrack and toddy to any other persons". At the same time, sub-r. (2) of r. 19 provided that "(2) where a licence is granted jointly, no licensee shall include or exclude any partner except with the previous permission of the licensing authority".

In both the cases considered in the said decision, the licence was granted in the name of an individual who in turn entered into a partnership with others for conducting and carrying on the business under the said licence. The High Court took the view that so far as sub-r. (1) of r. 19 is concerned, it did not prohibit entering into a partnership with respect to the business under the licence and that it merely prohibited the transfer of the licence. On this basis, the High Court held that the partnership entered into by the licensee(s) in the cases before them cannot be said to be opposed to or violative of sub- r. (1) of r. 19. So far as sub-r. (2) of r. 19 is concerned, the High Court construed it as not applicable to a case where the licence was granted in the name of a single person. The High Court opined that sub-r. (2) applied only where the licence was granted jointly in the name of two or more persons, i.e., to a partnership, in which case, it held, the sub-rule provided that no partners shall be excluded or included without the previous permission of the licensing authority. In the words of the High Court, the position under r. 19(2) is this : "Rule 19(2) requires that whenever a new partner is introduced or excluded, the previous permission of the licensing authority should be obtained. But if such permission is not obtained, the partnership is not rendered illegal. As between the partners it continues to be valid and entitled to registration under the IT Act". On the above reasoning, the High Court held that the two partnership agreements before them did not violate either sub-r. (1) or sub-r. (2) of r. 19 and cannot be refused registration under s. 185 of the IT Act. The correctness of the interpretation placed by the High Court on r. 19(2) does not fall for our consideration herein. Even so, we must say that the proposition, quoted by us hereinabove, is unacceptable as will be evident from the following discussion.

10. In our opinion, the correct position appears to be this (we are confining ourselves to partnership entered into with respect to a licence/permit granted under the State Excise enactments) : these enactments deal with intoxicating liquor, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquor (Entry 8 of List II of the Seventh Schedule to the Constitution) and other noxious substances besides providing for duties of excise referred to in Entry 51 of the said List. It has been held by this Court repeatedly that no person has a fundamental right to deal or trade in intoxicating liquors and that the State is entitled to prohibit and/or closely regulate their production, manufacture, possession, transport, purchase and sale. It is enough to refer to the recent Constitution Bench judgment in Khoday Distilleries Ltd. & Ors. vs. State of Karnataka & Ors. 1995 (1) SCC 574 wherein all the earlier decisions of this Court have been referred and the proposition aforesaid affirmed. The right of a citizen to deal in these intoxicating liquors is only to the extent it is provided for and permitted by the Act and the Rules made thereunder. Take the Madhya Pradesh Act, with which are concerned herein. Clause (VI) of the General Licence

Conditions - it is not disputed that these conditions are statutory in character - provides expressly that a holder of a licence/privilege shall not enter into a partnership for the working of such privilege in any way or manner without the written permission of the Collector, which permission shall be endorsed on the licence. This condition is binding upon the licensee. If so, he cannot enter into a partnership nor can there be, in law, a partnership with respect to the privilege (business) granted under the licence. No person, and no licensee, can claim any right contrary to the said provision. The object underlying the said clause is self-evident. Since the licence is granted for dealing in intoxicating liquors, the business wherein is *res extra commercium* - and also because they are supposed to be harmful and injurious to health and morals of the members of the society - close control is envisaged and provided over the business carried on under the licence. This object will be defeated if the licensee is permitted to bring in strangers into the business, which would mean that instead of the licensee carrying on the business, it would be carried on by others - a situation not conducive to effective implementation of the excise law and consequently deleterious to public interest. It is for this very reason that transfer or sub-letting of licence is uniformly prohibited by several State Excise enactments. It, therefore, follows that any agreement whereunder the licence is transferred, sub-let or a partnership is entered into with respect to the privilege/business under the said licence, contrary to the prohibition contained in the relevant excise enactment, is an agreement prohibited by law. The object of such an agreement must be held to be of such a nature that if permitted it would defeat the provisions of the excise law within the meaning of s. 23 of the Contract Act. Such an agreement is declared by s. 23 to be unlawful and void. The question is whether such an unlawful or void partnership can be treated as a genuine partnership within the meaning of s. 185(1) and whether registration can be granted to such a partnership under the provisions of the IT Act and rules made thereunder. We think not, when the law prohibits the entering into a particular partnership agreement, there can be in law no partnership agreement of that nature. The question of such an agreement being genuine cannot, therefore, arise. Where, of course, the statutory provisions or the conditions of licence do not prohibit the entering into of partnership, it is obvious, such a partnership cannot be held to be illegal, unlawful or void, as held by this Court in *Jer & Co.* (supra). But where there is a specific prohibition as in the case before us, any partnership entered into would be unlawful and void agreement within the meaning of s. 23 and no other law, whether State or Central, can recognise such an agreement. The fact that such a partnership can be permitted by the Collector does not detract from the mandatory character of the clause. As pointed out above, Licence Condition No. 14 expressly provides that for breach of any condition of licence or of the Act or the Rules made thereunder, the licence may be cancelled. The context - that it is an excise enactment - should not be forgotten. The grant of registration under the IT Act, it must be remembered, confers a substantial benefit upon the partnership firm and its members. There is no reason why such a benefit should be extended to persons who have entered into a partnership agreement prohibited by law. One arm of law cannot be utilised to defeat the other arm of law. Doing so would be opposed to public policy and bring the law into ridicule. It would be wrong to think that while acting under the IT Act, the ITO need not look to the law governing the partnership which is seeking registration. It would probably have been a different matter if the IT Act had specifically provided that registration can be granted notwithstanding that the partnership is violative of any other law - but it does not say so.

11. We may clarify that our holding does not mean that such an illegal partnership cannot be taxed. It is certainly bound to be taxed either as an unregistered partnership firm or as an AOP. The only question considered herein is its right to claim registration under the IT Act.

12. For the above reasons, the appeals are allowed. The application(s) under s. 256(2) filed by the assessee are allowed. The consequent reference is withdrawn to this Court and answered in the

affirmative, i.e., against the assessee and in favour of the Revenue. No costs.