

SUPREME COURT OF INDIA

The Commissioner of Income Tax, Andhra Pradesh.

Vs.

B. Posetty & Co.

(K Paripoornan and S V Manohar JJ.)

05.11.1996

JUDGMENT

PARIPOORNAN. J.

1. The Revenue has filed this appeal against the judgment of the High Court of Andhra Pradesh dated 22.8.1977 rendered in Case Referred No.45 of 1975. The High Court granted a certificate under Section 261 of the Income Tax Act to appeal to this Court, in S.C.L. Petition No.57 of 1978. The assessee is the respondent in this appeal. Since the respondent (assessee) was not represented, we requested Sri V.A. Bobde (senior counsel) to assist us. We heard counsel for the Revenue Sri. J. Ramamurthy and Sri V. A. Bobde.

2. The short question involved in this Appeal is :- Whether the respondent-assessee firm is entitled to registration under Income Tax Act for the year 1966-67? The Income Tax Officer by his order passed under Section 185 of the Income-tax Act, 1961, dated 28.12.1970, held that the respondent-assessee -- sub-partnership -- contravenes the provisions of Section 14 of the Andhra Pradesh (Telangana Area) Abkari Act (hereinafter referred to as 'the Abkari Act') and so, the sub partnership should be considered as void and illegal. Section 14 of the Act is to the following effect :

"No lessee shall, except with the Permission of Government, 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."

Registration was refused. The said order was confirmed in appeal by the Appellate Assistant Commissioner by order dated 28.2.1972. In further appeal, the Income tax Appellate Tribunal (the Tribunal) in I.T.A. No.210 (Hyd)/1972-73 by order dated 31.12.1973, held that the firm (sub-partnership) is valid and entitled to registration. In rendering the said order, the Tribunal noticed that another Bench of the Tribunal in I.T.A. No.1028 (Hyd) of 1969-70 and connected appeals had by an earlier order dated 30.6.1972, held that a sub-partnership on identical lines was not hit by section 14 of the Abkari Act. Concurring with the said view, the Tribunal further held that the business of sub partnership was not the same as that of the main partnership and all the insignia of a valid partnership are present in this case and so, it is valid and entitled to registration. It is thereafter, at the instance of the Revenue, the Appellate Tribunal referred the following question of law for the

decision Of the Andhra Pradesh High Court. "Whether on the facts and in the circumstances of the case, the subpartnership is entitled to the benefits of registration under the Income-tax Act, 1961 for the assessment year 1966-67?"

By the time the said reference came up for final hearing before the High Court, the reference made by the Tribunal of an identical question in the connected cases arising from I.T.A No. 1028 (Hyd) of 1969-70 was heard and decided by the High Court, holding that the sub-partnership in the said case, is valid and entitled to registration, vide judgment in Additional Income Tax Commissioner, Hyderabad v. D.G.G. Ramakishan & Co. [(1) 1977 TLR 244 = 111 ITR 93]. When the instant reference came up before the High Court, the earlier decision on the identical matter was noticed and the High Court answered the question in the affirmative and in favour of the assessee vide judgment dated 22.8.1977. It is thereafter, the Revenue moved the High Court in SCL Petition No.57/1978 under section 261 of the Income tax Act and having obtained a certificate to appeal to this Court vide order dated 10.3.1978 has tiled the above appeal.

4. At this stage, one fact deserves to be noticed. The decision of the Andhra Pradesh High Court rendered in Additional Income Tax Commissioner, Hyderabad v. D.G.G. Ramakishan & Co. [(1) 1971 TLR 244 = 111 ITR 93], came up in appeal before this Court, in Additional Commissioner of Income Tax v. Degaon Ganga Reddy G. Ramakrishna and Co. and Others [1995 (214) ITR 650], and a Bench of this Court affirmed the said decision. It was noticed that this Court had in Muralidhar Himatsingka vs. CIT (62 ITR 323) held 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 such sub-partnership is entitled to registration and then proceeded to state thus at (214 ITR 650) pages 653 to 655 :- "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 or 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 in liquor without the requisite licence in the name of the sub-partnership or in the name 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.....

".....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."

In the normal circumstances, the aforesaid decision of this Court reported in [1995 (214) ITR 650], should govern the decision in this case also. But, when the instant appeal came up for hearing before a Bench of two-Judges, after referring to the decision in Bihari Lal vs. CIT (217 ITR 746) it was observed :-

"..... As the profits of the business to be shared by the sub- partners were the profits of the main business, namely, abkari business, Section 14 of the Abkari Act squarely got attracted and made even the sub-partnership for sharing at least a part of the main partnership profits illegal as Section 14 of the Abkari Act was admittedly not complied with."

and so referred the matter for appropriate decision by a larger Bench of three-Judges (see AIR 1996 SC 1091- Income Tax Commissioner vs. B. Posetty). This is how the matter has come up before this Bench. A few facts to decide the question of law involved in this appeal may be stated. A partnership by name M/s. Nizamabad Group Sendhi Contractors, was formed evidenced by a Partnership Deed dated 15.10.1962, consisting of 17 partners. On 27th of August, 1963, Sri Ganga Goud, one of the partners in the said firm, and 11 others executed a Partnership Deed to the effect that Shri Ganga Goud after becoming a partner in the Nizamabad Group Sendhi 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 registration of the said sub- partnership was refused by the Income Tax Officer. It is the case of the said sub-partnership which finally reached this Court in the decision rendered in Additional Commissioner of Income Tax v. Degaon Ganga Reedy G. Ramakrishna and Co. and Others [1995 (214) ITR 650]. Similarly, in this case, Sri B. Posetty had 11 per cent share in the Nizamabad Group Sendhi Contractors. He found it difficult to contribute the required capital for the said share in the main firm. So, B. Posetty along with 9 others formed a sub-partnership as "B.Posetty & Company" on condition that they would provide the requisite finance on allotting certain share to them out of

Sri B. Posetty's income in the main firm. The main partnership, M/s. Nizamabad Group Sendhi Contractors, is a registered firm under the Income-tax Act. They are lessees who were the highest bidders in the auction held by the Excise authorities. The sub-partnership "B. Posetty & Company" is evidenced by Deed dated 20.1.1965 which specified the shares of each partner. This firm filed the application for registration for the assessment year 1966-67. On 30.9.1963, it returned an income, admitting 11 per cent share income of Sri B. Posetty in the firm Nizamabad Group Sendhi Contractors. The Income Tax Officer refused registration to the sub-partnership on the ground that the sub-partnership contravened the provisions of Section 14 of the Abkari Act, and so, void and unenforceable. It was affirmed in appeal. But, the Tribunal as well as the High Court granted registration.

6. The sole question that arises for consideration in this appeal is, whether the sub-partnership contravened Section 14 of the Abkari Act ?

7. Section 14 of the said Act runs thus: "No lessee shall, except with the permission of 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 Officer."

(emphasis supplied)

It will be appropriate to quote the relevant provisions of the Income-tax Act, 1961, dealing with registration as they existed during the relevant period: - Section 184

"(1) An application for registration of a firm for the purposes of this Act may be made to the Assessing Officer 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.

(2) Such application may, subject to the provisions of this section, be made either during the existence of the firm or after its dissolution.

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"(5) The application shall be accompanied by the original instrument evidencing the partnership, together with a copy thereof:

(6) The application shall be made in the prescribed form and shall contain the prescribed particulars.

(7) Where registration is granted or is deemed to have been granted to any firm for any assessment year, it shall have effect for every subsequent assessment year:

Provided that-

(i) there is no change in the constitution of the firm or the shares of the partners as evidenced by the instrument of partnership on the basis of which the registration was granted; and

(ii) the firm furnishes, before the expiry of the time allowed under sub-section - (1) of section 139

for furnishing the return of income for such subsequent assessment year, a declaration to that effect, in the prescribed form and verified in the prescribed manner, so, however, that where the Assessing Officer is satisfied that the firm was prevented by sufficient cause from furnishing the declaration within the time so allowed, he may allow the firm to furnish the declaration at any time before the assessment is made.

" Procedure on receipt of application 185. (1) On receipt of an application for the registration of a firm, the Assessing Officer 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."

We should remember that it is the main partnership, i.e., Nizamabad Group Sendhi Contractors who were lessees being the highest bidders in the auction held by the Excise authorities for the relevant year. The said partnership was registered by the Income Tax Department under the Income-tax Act. In the instant case, the Tribunal found the business of the sub-partnership is not the same as that of the main partnership and all the insignia of a valid partnership are present in the case and so, it is valid and entitled to registration. The said findings were not questioned before High Court by framing an appropriate question in that regard. In the instant case, the High Court followed its earlier decision reported in [111 ITR 93] wherein after noticing section 14 of the Abkari Act, the High Court held thus:

"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 as 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....."

The High Court further held that the sub-partnership had financed and owned the capital invested by one of its partners in the main firm and 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 such a sub-partnership is not prohibited by law.

8. Dealing with sub-partnership and its validity S.T. Desai on The Law of Partnership in India (6th Edn.) at page 152, states the law, thus:

"Sub-partnership may arise when as a result to an agreement between a partner in a firm and a

stranger the latter becomes jointly interested that partner so far as his share in the firm is concerned. Such mutual interests may amount to a partnership, but it is not a partnership in the main firm, but what is called a sub-partnership. Such an agreement will not have the effect of making the stranger a partner of the main firm. He will have no demand against that firm, nor will he be entitled to ask for accounts of its business so long as it continues to trade. It would hardly be questioned that a sub-partner is not liable to the creditors of the main firm for any of its debts.

Sub-partnerships have been recognised in India both before and after the present Act came into force. In *Murlidhar v. Income Tax Commissioner* (AIR 1967 SC 383 = 62 ITR 323) the Supreme Court quoted with approval the following statement of the law from Lindley on Partnership : A sub-partnership is, as it were, a partnership within a partnership; it presupposes the existence of a partnership to which it is itself subordinate. An agreement to share profits only constitutes Partnership between the parties to the agreement therefore, several persons are partners and one of them agrees to share the profits derived from him with a stranger, this agreement does not make the stranger a partner in the original firm. The result of such an agreement is to constitute what is called a sub-partnership, that is to say, it makes the parties to it partners inter se; but it in no way affects the other members of the principal firm."

(emphasis supplied)

In this case, the lessee is Nizamabad Group Sendhi Contractors (main firm). The sub-partnership is a distinct and different firm. It is one recognised by law and it is not a partnership with the main firm. It will not have the effect of making the partners in the sub-partnership, partners of the main firm. In other words, the main firm, the lessees and the sub partnership are distinct and different. In the light of the above legal position, it cannot be said that either the sub-partnership in the instant case, or any of its partners as a partner, became a partner of the main firm, Nizamabad Group Sendhi Contractors. The inhibition contained in Section 14 of the Abkari Act will apply only in a case where the lessee declares any person as its partner. Here, the lessees, M/s. Nizamabad Group Sendhi Contractors, had not declared either the sub- partnership or any other person, as its partner. In such circumstances, the inhibition contained in Section 14 of the Abkari Act cannot apply. It is true that Sri Posetty and 10 others formed the sub-partnership, "B. Posetty & Co." -- for a legitimate business purpose, to provide the requisite finance, on condition of allotment of certain shares to them out of Mr. Posetty's share in the main firm. The sub-partnership financed one of its partners to make a capital investment in the main firm. Such an arrangement or agreement between persons who formed a distinct and different firm, is valid in law and to such a situation Section 14 of the Abkari Act is not attracted; nor is there any basis to hold that there was any contravention of the provisions of the said Act. Law recognises formation of sub- partnership. The main partnership and the sub-partnership are, for the purpose of law, distinct and different entities. Registration cannot be refused to the sub- partnership on the ground that one of the partners of the main firm had agreed to share the profits received by him from the firm, with a stranger or strangers (members of the sub-partnership) since the agreement does not make the stranger or strangers or the sub-partnership firm, a partner in the original firm and such an arrangement or agreement does not affect either the main firm or its other members, in any way. Section 14 of the Abkari Act has no application to such a situation. We are of the view that on the facts similar to one in the instant case, the earlier decision of this Court in *Additional Commissioner of Income Tax v. Degaon Ganga Reddy G. Ramakrishna and Co. and Others* [214 ITR 650], has properly considered the entire matter and a reconsideration of the same is not called for. We should state that this Court in *Bihari Lal's case* (217 ITR 746) was dealing entirely with a different situation wherein clause VI of the General Licence conditions

prescribed by Madhya Pradesh Excise Rules, 1960, quoted at p. 750 of the report, was of very wide import and interdicted transfer or sub- lease of the licence or formation of partnership of the licence obtained by an individual in any manner or form. Such a situation is not present herein. The said decision is clearly distinguishable. In our view, the High Court was justified in law in answering the question referred to it, in the affirmative and in favour of the assessee. This appeal is without merit and is dismissed. There shall be no order as to costs.