

(1984) 04 RAJ CK 0010

In the Rajasthan High Court

Case No : Civil Income Tax Reference No. 38 of 1975

Additional Commissioner of Income Tax

APPELLANT

Vs

Rahmat Khan Faizukhan

RESPONDENT

Date of Decision : 17-04-1984

Acts Referred:

Income Tax Act, 1961 — Section 184, 185
Income Tax Rules, 1962 — Rule 22, 24

Citation : (1984) 41 CTR 264 : (1985) 152 ITR 676

Hon'ble Judges : S.K. Mal Lodha, J;K. Bhatnagar, J

Bench : Division Bench

Advocate : J.P. Joshi, for the Appellant; R. Mehta, for the Respondent

Judgement

Mal Lodha, J.—The Income Tax Appellate Tribunal, Jaipur Bench (hereinafter referred to as "the Tribunal"), has referred the following questions of law which arise out of its order dated April 22, 1974, for our decision :

"1. Whether, on the facts and in the circumstances of the case, and on a correct interpretation of the partnership deed the Tribunal was justified in holding that the partnership existed orally all along with effect from April 1, 1967, and that the partnership had not come into existence only from January 27, 1968, onwards?

2. If the answer to the above question be in the negative, was the Tribunal justified in holding that the firm was entitled to registration under the Income Tax Act, 1961, for the assessment year 1968-69 ?"

2. Shri Rahmat Khan is a partner in M/s. New Friends & Co., Dhamani Market, Jaipur. He had 121/2% share in the profit and loss of that firm, for the accounting period corresponding to the assessment year 1968-69 which began on April 1, 1967, and ended on March 31, 1968. Shri Rahmat Khan entered into an agreement of partnership with one Shri Faizu Khan S/o. Molabux in respect of his share of 121/2% in M/s New Friends & Co. The formal partnership deed was

drawn on January 27, 1968, between Shri Rahmat Khan and Shri Faizu Khan. The preamble to the partnership deed dated January 27, 1968, amongst others, contains the following recitals I

"..... and whereas the parties hereto have on and from April 1, 1967, agreed to be partners in the profit and loss of 121/2% in the name of the party hereto of the first part in the firm of M/s. New Friends & Co., Jaipur, and whereas to avoid future differences the parties have agreed to execute a deed of partnership."

3. It will also be useful to refer to Clauses 3, 4 and 6 of the partnership deed which are as under :

"3. The partnership business shall be for a period for which the party hereto of the first part may desire and he will be at liberty to keep the party hereto of the second part as partner or to refuse to keep him as partner. The party hereto of the second part shall have no claim whatsoever in this respect.

4. The party hereto of the second part has given Rs. 10,000 to the party hereto of the first part who has to invest the money in the firm of M/s. New Friends & Co. Party hereto of the second part shall not be entitled to any interest on this sum of Rs. 10,000. The amount shall be returned only when the full amount standing to the credit of the party hereto of the first part is received by him from the firm of M/s. New Friends & Co."

"6. The party hereto of the second part shall be actively engaged in the conduct of business of M/s. New Friends & Co., on behalf of the party hereto of the first part."

4. Shri Faizu Khan advanced Rs. 10,000 to Shri Rahmat Khan for investing the aforesaid amount in M/s. New Friends & Co. The profits received from M/s. New Friends & Co. by Shri Rahmat Khan was divided in accordance with the shares specified in the partnership deed between Shri Rahmat Khan and Shri Faizu Khan. The amount which was given to Shri Faizu Khan in accordance with the terms of the partnership deed was received by him. It was not appropriated by him for his own use. It may also be stated that there is no dispute that Shri Faizu Khan and Shri Rahmat Khan are not related in any manner. M/s. Rahmat Khan Faizu Khan, Bikaner (assessee-respondent), submitted an application for registration of the firm for the purpose of the I.T. Act, 1961 (Act No. XLIII of 1961) (for short "the Act" hereinafter), to the ITO concerned for registration of the firm and claimed registration u/s 185 of the Act on the basis of the partnership deed dated January 27, 1968. The ITO by his order dated February 25, 1972, declined to register the firm for the assessment year 1968-69, holding that the firm is not genuine as per reasons given in the assessment order for the assessment year 1968-69. The order of refusal to register the firm passed u/s 185(1)(b) of the Act was assailed by filing an appeal. The AAC of Income Tax, Bikaner Range, Bikaner, by his order dated September 30, 1972, confirmed the order of the ITO, refusing to register the firm. A further appeal was taken to the Tribunal. The only point before the Tribunal was whether the ITO and the AAC

were justified in refusing the registration to the firm M/s. Rahmat Khan, Faizu Khan Bikaner, regarding the assessment year 1968-69, The Tribunal by its order dated April 22, 1974, reversed the orders refusing to register the firm and directed that registration should be granted to the firm as per its request as it is a genuine firm as per the material on record.

5. An application u/s 256(1) of the Act was filed by the Commissioner of Income Tax to refer the questions stated in the application for the opinion of this court in respect of assessment year 1968-69. The Tribunal, however, has referred the two questions stated hereinabove for our decision.

6. Section 4 of the Indian Partnership Act, 1932 (Act No. IX of 1932) (for the sake of brevity it will be referred to as "the Partnership Act") defines "partnership", "partner" and "firm" as under :

"4. Definition of "partnership", "partner", "firm" and "firm-name".--"Partnership" is 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.

Persons who have entered into partnership with one another are called individually "partners" and collectively "a firm", and the name under which their business is carried on is called the "firm-name".

7. Section 6 of the Partnership Act lays down tests for determining the existence of partnership. The material portion of Section 6 for our purpose is as follows :

"6. Mode of determining existence of partnership.--In determining whether a group of persons is or is not a firm, or whether a person is or is not a partner in a firm, regard shall be had to the real relation between the parties, as shown by all relevant facts taken together."

8. Sections 26A and 23(4) of the Indian I.T. Act, 1922, were deleted and in their place Sections 184 and 186 have been incorporated in the new Act. Section 26A of the Indian I.T. Act, 1922, was examined in Commissioner of Income Tax, Madras Vs. Sivakasi Match Export Company, Subba Rao J., as he then was, with whom Sikri J. concurred, observed as under (p. 208).

"A combined effect of Section 26A of the Act and the rules made thereunder is that if the application made by a firm gives the necessary particulars prescribed by the rules, the Income Tax Officer cannot reject it, if there is a firm in existence as shown in the instrument of partnership. A firm may be said to be not in existence if it is a bogus or not a genuine one, or if in law the constitution of the partnership is void. The jurisdiction of the Income Tax Officer is, therefore, confined to the ascertainment of two facts, namely, (i) whether the application for registration is in conformity with the rules made under the Act, and (ii) whether the firm shown in the document presented for registration is a bogus one or has no legal existence. Further, the discretion conferred on him u/s 26A is a judicial one and he cannot refuse to register a firm on mere speculation, but he shall base his conclusion on relevant evidence."

9. Section 26A of the Indian I.T. Act, 1922, and Section 4 of the Partnership Act were again examined in *Agarwal and Co. Vs. Commissioner of Income Tax, Uttar Pradesh*, After reiterating the conditions essential for the registration of a firm as laid down in *Commissioner of Income Tax, Madras Vs. Sivakasi Match Export Company*, their Lordships held that if the conditions essential for registration of a firm are fulfilled, the ITO is bound to register the firm unless the assessee has contravened Section 23(4) of the Indian I.T. Act, 1922.

10. Sections 184 and 185 deal with registration of firms. It is well settled that the following conditions are essential for the registration of a firm u/s 185 of the Act I

(i) An application on behalf of the firm should be made to the ITO before the end of the accounting year and the application should comply with the requirements of Section 184 and Rules 22 to 24.

(ii) The firm should be evidenced by an instrument of partnership.

(iii) The instrument should specify the individual shares of the partners.

(iv) The partnership should be valid and genuine and should actually be constituted as specified in the instrument.

11. Before the Tribunal, on behalf of the Revenue, a contention was raised on the basis of the portion of the preamble of the partnership deed which has already been excerpted above that there was no partnership, oral or otherwise, existing between Rahmat Khan and Faizu Khan prior to January 27, 1968, that in fact the partnership was entered into between them from the date of the partnership deed, i.e., January 27, 1968, and further that the partnership deed could not bring into existence the relationship of partners with retrospective effect, i.e., from April 1, 1967. Reference was made before the Tribunal to the following clause in the partnership deed :

(i). "The name of the partnership shall be Rahmat Khan Faizu Khan."

12. The Tribunal has stated in its order as follows :

"In the present case, it is not the stand of the Department that S/Shri Rahmat Khan and Faizu Khan did not enter into an agreement to form a partnership. It has also not been disputed that in accordance with the said agreement, Shri Faizu Khan contributed Rs. 10,000 and further Shri Faizu Khan looked after the business of M/s New Friends & Co. It is also not the case of the Department that Shri Faizu Khan was a sham person who did not exist or who did not work and that he did not get the profits in accordance with the partnership deed or that he returned the profit to Shri Rahmat Khan. In our opinion, the aforesaid were the facts which were germane for determining the genuineness or otherwise of the firm. As none of them has been assailed, it cannot be disputed, in our opinion, that the partnership firm as stipulated by the above referred partnership deed had come into existence."

13. In P.R. Chowdhary and S. Gangoli Vs. The State of U.P., it was ruled that the firms which were created by word of mouth but the constitution of which had subsequently been reduced to writing can also, therefore, be registered u/s 26A of the Indian I.T. Act, 1922.

14. A Division Bench of the Punjab High Court in MESSRS. KALWANT SINGH GURDIAL SINGH Vs. COMMISSIONER OF Income Tax, PUNJAB., held that a partnership formed by an oral agreement but on terms and conditions reduced to writing subsequently is validly constituted within the meaning of Section 26A of the Indian I.T. Act, 1922 and is entitled to registration for assessment.

15. P.R. Chowdhary and S. Gangoli Vs. The State of U.P., was referred to while construing the partnership deed.

16. In Commissioner of Income Tax, Mysore Vs. Shah Mohandas Sadhuram, their Lordships observed that the partnership deed must be construed reasonably and that reasonable interpretation should be given to the deed.

17. We are tempted here to quote the following from Ram Laxman Sugar Mills Vs. Commissioner of Income Tax, Uttar Pradesh and Another, wherein the agreement of partnership was construed and in that connection it was observed (p. 616) :

"In adjudicating upon that plea the court has in the first instance to determine the intention of the parties as disclosed by the recitals in the deed of partnership and other relevant circumstances.....In ascertaining the legal effect of a transaction, the court seeks in the first instance to determine the intention of the parties, and when ambiguous expressions are used, the court may normally adopt that interpretation which upholds the deed, if the parties thereto have acted on the assumption of its validity.,,," (underlining* is our own).

18. Applying the tests laid down in the aforesaid authorities and having regard to the dominant intention of the parties and considering the partnership deed as a whole, it is clear that the parties in the partnership deed had agreed to be partners in the profit and loss on and from April 1, 1967, and the terms were reduced to writing on January 27, 1968, the date when the partnership deed came into existence. This has to be considered in the light of the following facts and circumstances regarding which no dispute has been raised on behalf of the Revenue. There is no dispute that Shri Rahmat Khan and Shri Faizu Khan had entered into an agreement of partnership, that a sum of Rs. 10,000 was paid by Shri Faizu Khan and that since then Shri Faizu Khan had been looking after the business of M/s New "Friends" & Co. It was a partnership firm u/s 4 of the Partnership Act. The words "hereto have on and from April 1, 1967" are not without significance. The intention of the parties was that they had agreed to be partners from April 1, 1967. Real intention of the parties to the partnership is one important test u/s 6 of the Partnership Act. In our opinion, the Tribunal was right in rejecting the interpretation put on behalf of the Revenue on the partnership deed that the partnership had come into existence only from January

27, 1968, i.e., from the date the partnership deed had come into existence. The correct interpretation is that the partnership was entered into from April 1, 1967, and that the partnership firm was genuine from that date. As the conditions essential for the registration of the firm for the assessment year 1968-69 were satisfied, the respondent was entitled to registration u/s 185 of the Act from April 1, 1967. The Tribunal was right and justified when it held that the partnership existed orally all along with effect from April 1, 1967, and had not come into existence only from January 27, 1968, and onwards.

19. For the reasons aforesaid, our answer to the first question is in the affirmative, i.e., in favour of the respondent and against the Revenue.

20. In view of our answer to the first question in the affirmative, it follows as a necessary consequence that the respondent was entitled to registration under the Act in respect of the assessment year 1968-69. The second question is also answered in the affirmative, in favour of the respondent and against the Revenue.

21. In the circumstances of the case, we leave the parties to bear their own costs of this reference. Let the answers to these questions be returned to the Tribunal for necessary action u/s 260 of the Act.