

(1980) 07 AHC CK 0055

In the Allahabad High Court

Case No : Income-tax Reference No. 730 of 1976

Commissioner of Income Tax

APPELLANT

Vs

Gupta Brothers

RESPONDENT

Date of Decision : 07-07-1980

Acts Referred:

Contract Act, 1872 — Section 2, 25
Income Tax Act, 1961 — Section 185
Partnership Act, 1932 — Section 4

Citation : (1980) 19 CTR 342 : (1981) 131 ITR 492

Hon'ble Judges : R.R. Rastogi, J;C.S.P. Singh, J

Bench : Division Bench

Advocate : R.K. Gulati and A. Gupta, for the Appellant; K.B. Bhatnagar, for the Respondent

Final Decision : Dismissed

Judgement

C.S.P. Singh, J.—The assessee is a firm. The dispute relates to the assessment year 1973-74. Originally this firm consisted of Sri Mata Prasad and Sri Lakhan Lal. These persons were partners in the firm as karta of their HUFs, and had 50% share each. With effect from 1st April, 1972, Sri Pradeep Kumar, a junior member of the family of Sri Mata Prasad; also joined the firm as a partner. This was done by executing a partnership deed on April 24, 1972. Sri Pradeep Kumar did not bring any capital of his own for investment in the firm. The deed recited that Mata Prasad and Lakhan Lal shall continue to be partners on behalf of their respective HUFs having a share of 40% each, and Pradeep Kumar, who was being taken in as a working partner, was given 20% share. The reconstituted firm applied for registration u/s 185 of the Act. The ITO rejected the application following the decision of the Bombay High Court in the decision in Manilal Dharamchand Vs. Commissioner of Income Tax, Poona, . The assessee appealed, but the AAC held that Pradeep Kumar could not become a partner in the firm in which his HUF was already a partner through its karta. In his view this would amount to an agreement of partnership by Pradeep Kumar with himself. The

assessee appealed. The Tribunal held that Pradeep Kumar had been taken as a working partner, and as such the partnership was valid. It rejected the department's plea that there was no valid partnership as Pradeep Kumar had not contributed any cash or other assets of his own in the partnership property. In doing so it followed the decision of the Mysore High Court in the case of I.P. Munavalli Vs. Commissioner of Income Tax, Mysore, .

2. Now, partnership is the relation arising out of a contract between persons to share the profits of a business. Being a contract it must be founded on some consideration so that it should be binding. It is not necessary that the consideration should be cash or property in order that a binding contract comes into existence. It may take the shape of capital, but it may also take the shape of labour and skill. This view is amply borne out by the relevant provisions of the Partnership Act, and the Contract Act. We may refer to them :

""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."

3. Thus, the foundation of a partnership is an agreement. Now, this agreement is a valid and enforceable one, and is a contract as defined by Section 10. For all agreements there has to be a proposal (Section 2(a), Contract Act) and an acceptance (Section 2(b) of the Contract Act), and consideration (see Section 25 of the Contract Act), for the reciprocal promises. Section 2(d) defines " consideration ". It says :

" When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise."

4. Now, as Section 2(d) does not specifically say that consideration must take the form of money and property. It is thus not necessary that in order to constitute a partnership each partner must bring in some money or property. As observed by vice Chancellor Wigram in Dale v. Hamilton [1846] 5 Har 369 at p. 393:

" if one man has skill and wants capital to make that skill available, and another has capital and wants skill, and the two agree that the one shall provide capital and the other skill, it is perfectly clear that there is a good consideration for the agreement on both sides, and it is impossible for the court to measure the quantum of value. The parties must decide that for themselves."

5. It is as such not necessary that before a partnership comes into existence each partner must contribute capital in the firm. It is sufficient that the consideration, for the partnership contract is skill and the labour which a working partner puts. Counsel for the revenue, however, urged that although it is possible for a junior member of a coparcenary to enter into a partnership with the kartas of HUFs, but that can be done in case he brings his separate property into partnership assets. It was contended that inasmuch as the karta of a HUF is a

partner of the firm in a representative capacity, in the event of a junior member not bringing separate property into the partnership assets it would amount to creating a partnership inter se, which would cut at the root of a joint undivided family. This contention is based on the decision of the Supreme Court in the case of *Firm of Bhagat Ram Mohanlal Vs. The Commissioner of Excess Profits Tax, Madhya Pradesh, Nagpur and Another*, . The Bombay High Court in *Manilal Dharamchand Vs. Commissioner of Income Tax, Poona*, held likewise. There is another decision of the Bombay High Court taking the same view in the case of *Shah Prabhudas Gulabchand Vs. Commissioner of Income Tax, Bombay*, . We, however, think that these cases are distinguishable.

6. In *Firm of Bhagat Ram Mohanlal Vs. The Commissioner of Excess Profits Tax, Madhya Pradesh, Nagpur and Another*, , a partnership consisted of the karta of the HUF and two other persons. The joint family disrupted, and the firm was reconstituted on October 17, 1944. Under the new deed, the kartas of the erstwhile HUFs "B" and "C" and erstwhile partners "D" and "E" became partners. D and E were members of the joint family of which A continued to be the karta. One of the questions that arose was as to whether the junior members could become partners in the firm of which the karta was also one of the partners. The Supreme Court referred to the decision of the Privy Council in the case of *Lachhman Das v. CIT* [1948] 16 ITR 35, wherein it was held that the karta of an HUF could enter into a partnership with an individual member of the coparcenary qua his separate property. They also referred to the decision of the Privy Council in the case of *Sundar Singh Majithia v. CIT* [1942] 10 ITR 457, wherein it was held that there was nothing in the I.T. Act to prohibit the members of a joint Hindu family from dividing some property while electing to retain their joint status, and carrying on business as partners in respect of the divided properties treating them as their capital. After considering these cases, the Supreme Court held that D and E, the junior members, could not become partners in their individual capacities, because they had no separate or divided properties.

7. The observations of the Privy Council in *Lachhman Das's* case [1948] 16 ITR 35 that a junior member of a coparcenary can enter into a partnership qua his separate property has been dogmatically relied upon by the revenue, as being exhaustive of the circumstance in which a junior member can enter into a partnership with the karta of an undivided Hindu family. This can only be done in case we read the Privy Council's decision and the Supreme Court's decision as supplanting the statutes on partnership and contract. This, however, is not possible. These decisions only apply to cases where the junior member is inducted as a partner without any consideration as contemplated by the Contract Act, but where he is taken in as a partner in consideration of the labour and skill, which he contributes to the partnership, the difficulty is avoided.

8. In *Shah Prabhudas Gulabchand Vs. Commissioner of Income Tax, Bombay*, *Chandra Kant Prabudas*, a junior coparcener, was taken as a partner in the

business of the HUF. The court took the view that it was necessary for the junior member to bring separate property in the firm, but held that the partnership was valid as the coparceners had brought their separate property in the firm. The court left open the question as to whether a valid partnership is created when a junior member contributes labour and skill only.

9. In *Manilal Dharamchand Vs. Commissioner of Income Tax, Poona*, a partnership was formed by four persons, Manilal, Keshavlal, and their respective sons, Rasiklal and Champalal. In the preamble to the deed Manilal Dharamchand was described as the manager of and representing the HUF of himself, his wife and children, and similarly Keshavlal Dharamchand was described as the manager of and representing the HUF of himself, Ms wife and children. Rasiklal and Champalal were described as having become partners in their individual capacity. The entire capital of the firm came from the HUF. No capital was introduced into the firm by any of the partners and the whole of it was by way of loan from the HUF. It was held that no valid partnership came into existence, for, the junior members have not brought any separate property, and the entire capital came from the HUF whose karta was the partners of the firm. It will be noticed that none of these junior members were inducted as working partners in the firm, and had not agreed to contribute their labour and skill as consideration for the partnership contract. These cases in our view cannot be extended to cases where junior members of the family are inducted into a partnership in consideration of the labour and skill which they put in. The observations of the Privy Council in the case of *Lachhman Das v. CIT* [1948] 16 ITR 35 to the effect that a karta of a HUF can enter into a partnership with an individual member of the coparcener qua his separate property should not be read as limiting the other ways by which a partnership agreement can come into existence. In case a junior member brings his separate property that will constitute consideration for the contract of partnership. But as all that is required under the Contract Act is that there should be consideration for the reciprocal promises, the Privy Council's decision should not be taken as imposing any limitation for formation of a partnership contract between a karta and a junior member, other than as contained in the Contract Act or the Partnership Act. The observations of the Privy Council that a partnership can be formed with a junior member by the karta qua his separate property is by way of illustration of a particular eventuality when the separate property constitutes consideration for the induction of a junior member into the partnership. It cannot be read as being exhaustive of cases where consideration may take other forms. Now, as labour and skill would also be consideration as contemplated by the Contract Act, a valid partnership had come into existence, which ought to have been registered.

10. We find ourselves in agreement with the view expressed by the Mysore High Court in *I.P. Munavalli Vs. Commissioner of Income Tax, Mysore*, . The decision of the Tribunal is right.

11. We accordingly answer the question in the affirmative, in favour of the

assessee and against the department. The assessee is entitled to its costs, which are assessed at Rs. 200. The counsel's fee is assessed at the same figure.