

(2006) 07 GUJ CK 0058
In the Gujarat High Court

Case No : Income Tax Reference No's. 110 of 1992 and 35 of 1995

Commissioner of Income Tax

APPELLANT

Vs

Swashraya

RESPONDENT

Date of Decision : 12-07-2006

Acts Referred:

Contract Act, 1872 — Section 10, 11, 239, 240, 241
Income Tax Act, 1961 — Section 185, 256(2)
Partnership Act, 1932 — Section 4
Trusts Act, 1882 — Section 47

Citation : (2006) 205 CTR 290 : (2006) 286 ITR 265

Hon'ble Judges : R.S. Garg, J; Mukesh R. Shah, J

Bench : Division Bench

Advocate : Manish R. Bhatt, for the Appellant;

Judgement

R.S. Garg, J.—The Income Tax Appellate Tribunal, in accordance with the directions of this Court issued u/s 256(2) of the Income Tax Act, 1961, has made these References to this Court to answer the following common question;

Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that the partnership consisting of the trustees deriving authority under the different trust deeds was genuine and valid, and whether such partnership was entitled to registration u/s 185 of the Income Tax Act, 1961 for the assessment year 1975-76, and continuation thereof for the subsequent assessment years?

The facts for proper appreciation of the References, in the nutshell, are that under a partnership deed dated 26.6.1973 as many as 7 persons created a partnership, with various objects like entering into business of money-lending, trading etc. The Partnership Deed provided that each one of the said persons was representative of a Trust which was created by a Trust Deed duly made in accordance with law. The assessee firm applied for registration for the assessment year 1975-76, the application was granted for the said year but

while considering the application for renewal of registration for assessment year 1976-77, the Income Tax Officer held that there was no legal and valid partnership subsisting between the partners since the Trust Deed did not authorise the concerned trustees to join as partners or to join in any business. He observed that there was clear violation of Section 47 of the Trust Act, accordingly he refused registration for the assessment year 1976-77 and cancelled the registration earlier granted for the assessment year 1975-76.

2. The Commissioner of Income Tax (Appeals), for the reasons stated in his order, set aside the order of the Income Tax Officer and held that the assessee was entitled to registration. The matter came up before the Tribunal. The Accountant Member held that the assessee was entitled to registration, but the Judicial Member, on the other side, held that in view of the clear legal position the assessee was not entitled to any registration and the order passed by the Income Tax Officer was upheld. As there was a dispute amongst the Members in relation to registrability of the assessee, the matter was referred to the learned Vice President, who, by his separate order, agreed with the reasonings and findings recorded by the Accountant Member. The learned Vice President, while agreeing with the Accountant Member, observed that the trustees would not be held to have no authority and they were rightly joining a partnership and in any case if they were committing any breach of the terms of the Trust Deed, then they were answerable to the beneficiaries but in any case the partnership was valid and was entitled to registration. The Revenue made an application for Reference but the Tribunal declined to make the Reference and therefore the Revenue came to this Court u/s 256(2) and on the basis of order of this Court the Tribunal has now made these References.

3. Notices were issued to the respondents but despite service of the notices none appears for the respondents.

4. The matter was listed yesterday but unfortunately none appeared for the respondents. Instead of taking up the matter yesterday, we adjourned it for today. But even today, none appears on behalf of the respondents. Shri Naik, learned Counsel for the petitioner submits that registration u/s 185 can be given to a firm which is legal and validly constituted and the partners have an authority under the law to constitute a firm or are competent to enter into a contract for creating a partnership. His submission is that Section 185 (unamended) does not authorise an illegally constituted firm to make an application for registration. His further submission is that if an Assessing Officer finds that the firm has been illegally constituted or has been constituted for illegal or immoral purposes or the partners entering into the partnership are not authorised or entitled either under the law or under a covenant to enter into a partnership or are not entitled or competent to enter into a contract because of some disqualification or disability a legally constituted partnership would not come into existence and in case the Assessing Officer finds that no legally constituted valid partnership has come into existence, he can always refuse registration. He has referred to provisions of

Section 47 of the Trust Act, Clause 3(iv) of the Trust Deed, Section 11 of the Indian Contract Act, and Section 4 of the Indian Partnership Act. He submits that if a partnership is created then one must see that a trustee, who joins as a partner, has an authority under the Trust Act, under any other allied law or under the document created by the said Trust and if such authority is not available to such a trustee then inclusion of Trustee as a partner and creation of the partnership would be bad.

5. Section 47 of The Indian Trusts Act, 1882, observes that a trustee cannot delegate his office or authority. It reads as under;

47. Trustee cannot delegate.

A trustee cannot delegate his office or any of his duties either to a co-trustee or to a stranger, unless (a) the instrument of trust so provides, or (b) the delegation is in the regular course of business, or (c) the delegation is necessary, or (d) the beneficiary, being competent to contract, consents to the delegation.

According to Section 47, A trustee cannot delegate his office or any of his duties either to a co-trustee or to a stranger, unless (a) the instrument of trust so provides, or (b) the delegation is in the regular course of business, or (c) the delegation is necessary, or (d) the beneficiary, being competent to contract, consents to the delegation. From a perusal of Section 47, it would clearly appear that a trustee cannot delegate his office or any of his duties unless the instrument of trust so provides or the consent is given by the beneficiary provided the beneficiary is competent to contract. Section 11 of The Indian Contract Act says that every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind and is not disqualified from contracting by any law to which he is subject.

6. A legally enforceable contract would come into existence if the person is competent to contract, if the person opting for contract is major, is of sound mind, and is not disqualified from contracting by any law to which he is the subject.

7. It cannot be disputed that a partnership is a written contract between the parties to do or not to do an act and who would stand authorised to do the act on behalf of the authors. It is also to be noted that the law relating to partnership was contained in Chapter XI consisting Sections 239 to 266 of the Indian Contract Act, 1872, the provisions were found neither adequate nor satisfactory were thus repealed, with the development of the trade in India the necessity of new legislation on partnership was felt. The present Partnership Act is a little development and modification on the English Partnership Act, 1890.

8. Section 4 of the Indian Partnership Act defines "partnership" as a relation between persons who have agreed to share the profits of a business carried out by all or any of them acting for all. Persons who have entered into partnership with one another are called partners and collectively "firm", and the name under

which their business is carried on is called Sfirm name?. Thus, from Section 4, it would appear that for coming into existence of a partnership there must be an agreement between two and more persons. Section 10 of the Indian Contract Act, 1872, provides that all agreements are contracts if they are made by the free consent of parties competent to contract, (emphasis supplied) for a lawful consideration and with a lawful object and are not expressly declared to be void. Once the provisions of the Contract Act are applicable, then the capacity, ability and capability to contract of each person proposing to join the partnership would become material for Section 4 of Partnership Act.

9. Submission of Shri Naik is that if the Trust Deed does not authorise a trustee to delegate his authority in favour of any body to handle or invest the property, then no authority can be conferred by a trustee in favour of any other person/partner of a firm in relation to Trust property. His submission is that if the law prevents a trustee from doing such an act then he would not be entitled to enter into a contract of partnership and his act would become illegal for purposes of Section 11 of the Indian Contract Act.

10. Section 47 of the Trust Act clearly puts an embargo on the authority of trustee when it says that a trustee cannot delegate his office or any of his duties either to a co-trustee or to a co-stranger, unless;

- (a) the instrument of Trust so provides, or
- (b) the delegation is in the regular course of business, or
- (c) the delegation is necessary, or
- (d) the beneficiary, being competent to contract, consents to the delegation.

So far as the authority under the Trust Deed is concerned, from a very perusal of Clause 3 of the Trust Deed, it would appear that the Trustees are entitled and expressly authorised to invest the Trust funds or any monies subject to the Trust Deed in any such securities or investments as the trustee may deem fit, whether such securities or investments be authorised or not by law for investment of the Trust funds and to vary or transpose any such investments for or into others as they may from time to time think fit and without prejudice to general power conferred upon the trustees they have been authorised to invest in shares, stock, debentures, or debenture stock or bond of any company (Private or Public) or corporation or municipality or legal authority or local body in or outside India, they may invest in deposits with interest with any person, firm or company or any Bank or Banks. They may also invest in relation to loan on security, and they would also be entitled to invest in any other securities or investments not specifically provided if the trustees in their absolute and uncontrolled wisdom consider this investment to be suitable or advantageous. Clause 4(3) of Trust Deed authorises the trustees to invest the property exercising their discretion but that does not give them an authority to become a partner and invest the money through the help and assistance of a firm. We could understand a case that the

Trustees on the authority conferred upon them under Clause 3 were investing money of the Trust in shares, stocks, debentures deposits, were extending loan on security or were making investments in some other securities or so but we cannot hold that creation of the partnership was authorised in favour of the trustees. Up to the date of the order of assessment, the beneficiaries did not come and say to the Assessing Officer that the instrument of the Trust did not authorise the trustee to delegate his office or any of his duties but the beneficiary being competent to contract was consenting to such delegation or specifically authorised the trustee to create and enter into a partnership. When Section 47 says that a trustee cannot delegate his office or any of his duties unless the instrument of Trust so provides or the delegation is in the regular course of business or the delegation is necessary or the beneficiary, being competent to contract, consents to delegation and when none of the conditions enumerated in Section 47 of The Indian Trusts Act, 1882 is applicable, then as a sequel to the aforesaid discussion it has to be held that Section 47 puts a bar against the Trustee to delegate his office or any of his duties in favour of a co-trustee or to a stranger.

11. This also will have to be appreciated that a partner who is not a trustee, qua the Trust, would be a stranger and if the trustee of a particular Trust enters into an agreement of partnership with any third party, then he virtually delegates his office or his duties in favour of a stranger.

12. This also will have to be noted that a trustee is not entitled to go beyond the authority conferred upon him under the Trusts Act and if he does something beyond his authority then, he can always be held answerable in the Civil and Criminal Courts. For the purposes of Section 47, delegation of the office or duty must be consented by the beneficiary who is competent to contract.

13. Section 4 of The Indian Partnership Act, 1932, as we have already observed, defines that 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. The moment a partnership is created consequent to the agreement, the partners, each of them may carry on the business or they may confer authority on some or one of them to do something in the interest of the firm and the partners. The moment the partners confer authority on some or one of them, then they delegate their powers in favour of the acting partner or partners. If a trustee joins the partnership which is to handle the Trust money and the trustee gives an authority to other partners to handle the money, then virtually he is giving up his office and is delegating his duties in favour of other partners.

14. Even otherwise, a Trustee, who has not been authorised under the Trusts Act or whose action has not been approved by the beneficiary, cannot be held entitled under law to enter into a contract for and on behalf of the Trust. Section 11 of the Indian Contract Act, to which we have earlier referred, clearly provides that every person would be competent to contract provided he is major according to law to which he is subject and who is of sound mind and is not disqualified

from contracting by any law to which he is subject. A clear understanding of the provisions of the law would make it clear that all the three conditions so imposed must co-exist. A person would be competent to contract if he is major, is of a sound mind and is not disqualified from contracting by any law to which he is subject. In the present matter, there is no dispute that the trustee is major and is of sound mind, but the third condition, which is required as the third leg of the tripod is not available in favour said trustee/partner because he does not fulfill the condition that he is not disqualified from contracting by any law to which he is subject. The burden to prove, that such trustee/partner is not disqualified, would always be upon the Trustee. If a trustee/partner fails to prove his authority to join as a partner, then being under legal disqualification he cannot contract for creation of a legal partnership.

15. Once Section 47 of the Trusts Act puts an embargo on the authority of the trustee that he cannot delegate his office or any of his duties either to a co-trustee or to a stranger, then he would be a person disqualified u/s 47 of the Trusts Act. If it is not the case of the trustee that the delegation was in the regular course of the business or the delegation became necessary, then, for all practical purposes, he is disqualified under the law to which he is subject. If a person is disqualified from entering into a partnership, no legally constituted partnership would come into existence. Section 11 of The Indian Contract Act would provide foundational capability to enter into an agreement which ultimately would be an enforceable contract. Coming into existence of a legal partnership u/s 4 of the Act would be a consequence of a legal agreement which can be entered into by a person entitled to contract u/s 11 of the Contract Act. If the person is not authorised to enter into an agreement, then the consequent partnership would be bad and illegal.

16. In the present matter, the Tribunal brushed aside the main question in relation to the authority of the trustee to contract and enter into a partnership simply by saying that, if the trustee himself commits a wrong or misconduct, then the beneficiaries can take an action against him. Unfortunately the Tribunal did not focus its attention to the main question that a trustee is not entitled to enter into a partnership if the Trust Deed does not permit him. No consent has been given by the beneficiaries to his act and if Section 11 of the Indian Contract Act ostracizes a person under disqualification, then no legal partnership would come into existence.

17. Section 185 of The Indian Income Tax Act talks of registration of a partnership. A partnership must be legal, and the partners must not suffer with any disqualification. In the present case, no legal partnership came into existence and therefore the provisions of Section 185 of The Indian Income Tax Act, would not come into play in favour of the assessee.

18. According to Section 185 of The Income Tax Act, on receipt of an application for registration of the firm, the Assessing Officer is obliged to inquire into the genuineness of the firm and its constitution as is specified in the instrument of

partnership. The Assessing Officer is required to inquire into the genuineness of the firm, so also into the constitution. The constitution of the firm may be with some laudable object but it must have 2 or more persons who are competent to enter into a contract. In absence of fulfillment of legal requirement, no valid and legal partnership would come into existence. In a case where the very creation of a partnership is by the persons who are under disqualification and could not enter into an agreement of partnership, then the partnership would be bad and an Assessing Officer would be entitled to reject the application for registration.

19. In the present matter, in our considered opinion, the Assessing Officer was absolutely justified in observing that no valid partnership subsisted between the partners since the Trust Deed did not authorise the concerned trustees to join as partners.

20. It is yet to be seen that, the Tribunal had observed that the trustees have joined the partnership in their individual capacity. This observation made by the learned Members of the Tribunal is contrary to the Partnership Deed dated 26.6.1973.

21. The Partnership Deed was made at Ahmedabad on 26th day of June 1973 between 7 persons and each of the said person after describing his name was referring himself or herself to be a representative of a particular Trust. For example, party of the First Part, Smt. Shayma G. Sarabhai represents Saraladevi Sarabhai D. Trust. The other persons who joined as partners were also representing the Trust. If they were representing the Trust, then the Tribunal could not say that the trustees joined in their personal capacity and for act of misfeasance, malfeasance or misconduct they were answerable to the beneficiaries and irrespective of all other things the partnership was entitled to be registered. In our humble opinion and without meaning any disrespect to the Members of the Tribunal, we must observe that they misread the Trust Deed and the covenants of the Partnership Deed. They misapplied the letter of law and came to a wrong conclusion.

22. As a sequel to the aforesaid discussion, we hold that, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was not right in law in holding that the partnership, consisting of the trustees deriving alleged authority under the different Trust Deeds, was genuine and valid. We must also hold that the Trust Deed did not confer any authority upon the trustees, and, on the facts and in the circumstances of the case, the partnership, created by 7 representatives of different Trusts, was not entitled to registration u/s 185 of The Income Tax Act, 1961, and that the Assessing Officer was justified in cancelling its registration for the year 1975-76 and was also justified in refusing the renewal of the said registration.

23. We answer the References accordingly in favour of the Revenue. No costs.