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**(1984) 11 AP CK 0022**  
**In the Andhra Pradesh High Court**  
**Case No : R.C. No. 164 of 1979**

Modern Stores

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

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**Date of Decision :** 06-11-1984

**Acts Referred:**

Income Tax Act, 1961 — Section 185, 185(1)

**Citation :** (1985) 48 CTR 8 : (1986) 157 ITR 589

**Hon'ble Judges :** Y.V. Anjaneyulu, J;A. Raghuvir, J

**Bench :** Division Bench

**Advocate :** S. Dasaratharama Reddy and S.R. Ashok, for the Appellant; M. Suryanarayana Murthy and A.V. Krishna Koundinya, for the Respondent

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## Judgement

Y.V. Anjaneyulu, J.—This reference arise u/s 256(1) of the Income Tax Act, 1961. The matter relates to the Income Tax assessment year 1975-76. The assessee is a partnership firm constituted under a deed dated August 20, 1973. Prabhakar Gupta, a minor, was admitted to the benefits of this partnership. Apart from the minor, there are four other adult partners. All of them share profits equally. In the event of losses, the four adult partners agreed to share them equally. The assessee's previous year relevant to the assessment year 1975-76 was the financial year 1974-75. On October 31, 1974, Prabhakar Gupta attained majority. It appears, he exercised the option u/s 30(5) of the Indian Partnership Act, 1932, to become a partner in the firm. On December 19, 1974, a fresh deed of partnership was executed among all the partners including the minor, Prabhakar Gupta, who attained majority. The assessee made an application for registration of the firm evidenced by the deed of partnership dated December 19, 1974, for the Income Tax assessment year 1975-76. The assessee's claim for registration was rejected by the Income Tax Officer on the following grounds :

- (i) There was no operative deed from April 1, 1974, to October 30, 1974;
- (ii) The agreement dated December 19, 1974, could not have retrospective effect with effect from April 1, 1974; and

(iii) If the partnership deed dated December 19, 1974, is given effect to from April 1, 1974, Prabhakar Gupta, who was a minor till October 30, 1974, would be obliged to share the losses of the firm during the period April 1, 1974, to October 30, 1974. In that event, the partnership deed which provided for sharing of loss by the minor is bad in law.

2. The assessee appealed unsuccessfully to the Appellate Assistant Commissioner against the order of the Income Tax Officer refusing the registration. A second appeal was also filed before the Income Tax Appellate Tribunal and the Tribunal upheld the order of the Income Tax Officer and rejected the assessee's claim for registration. At the instance of the assessee, the Income Tax Appellate Tribunal referred the following question of law for the opinion of this court :

"Whether, on the facts and in the circumstances of the case, the assessee would be entitled to the registration u/s 185 of the Income Tax Act particularly taking into account the provisions of section 62 of the Contract Act ?"

Sri Dasaratharama Reddy, learned counsel for the assessee, contended that the partnership deed executed on December 19, 1974, was perfectly valid in law, as Prabhakar Gupta, who attained majority by the date of execution of the deed, was competent to take upon himself the obligation to bear the losses, if any, arising during the period he was a minor. According to the learned counsel, there is no prohibition in law to a major partner undertaking whatever obligations and responsibilities he wants to take upon himself, even if such obligations and responsibilities related to the period when he was a minor admitted to the benefits of partnership. Learned counsel further contended that clause 14 of the partnership deed dated December 19, 1974, could not be held to give retrospective effect with effect from April 1, 1974. Learned counsel urged that the question of Prabhakar Gupta being obliged to share any losses between April 1, 1974, and October 30, 1974, did not arise, as the books of account of the partnership were not closed on any date during that period and under clause 14, the books of account were required to be closed on March 31, 1975. Learned counsel submitted that profits or losses accrue only when the accounts are closed and the profits and losses ascertained. That ascertainment was done on March 31, 1975, and Prabhakar Gupta was, therefore, competent to bear his share of loss, if any, arising on ascertainment of profits and losses on March 31, 1975. On these grounds, the learned counsel for the assessee assailed the order of the Tribunal.

3. Sri M. Suryanarayana Murthy, learned standing counsel for the Revenue, reiterated the Revenue's plea that there was no operative deed of partnership between April 1, 1974, and October 30, 1974. If clause 14 of the deed of partnership dated December 19, 1974 should be interpreted as giving retrospective effect to the partnership with effect from April 1, 1974, according to the learned standing counsel, the partnership would be invalid as it would amount to the minor partner being required to share losses during the period between April 1, 1974, and October 30, 1974. According to the learned standing

counsel, a minor could not be burdened with losses arising to a partnership. Learned standing counsel further submitted that, although, in principle, profits or losses accrue on the date when the accounts are closed, it must be held that profits accrue from day to day and ascertainment is made only at the end of the year. Thus, the transactions between April 1, 1974, and October 30, 1974, when Prabhakar Gupta was a minor, could have resulted in losses and clause 14 of the partnership deed dated December 19, 1974, could not require the minor to share the loss arising prior to his attaining majority. As the effect of clause 14 of the partnership deed is to impose such a burden on the minor to share the loss up to October 30, 1974, learned standing counsel for the Revenue submitted that the partnership itself is void ab initio. On these grounds, the learned standing counsel supported the order of the Tribunal rejecting the assessee's claim for registration of the firm.

4. The facts stated above unmistakably indicate that the assessee was requiring registration of the firm evidenced by the deed of partnership dated December 19, 1974. It is not in dispute that, on that date, Prabhakar Gupta was a major and was competent to enter into a contract with others. Obviously, therefore, there was nothing illegal on the face of the deed of partnership executed on December 19, 1974, as the agreement was between adults competent to contract under the law. It must also be stated that the competency of Prabhakar Gupta to take upon himself obligations and responsibilities associated with the business carried on by the partnership firm during the period he was a minor is not open to question. Undoubtedly, on December 19, 1974, Prabhakar Gupta, being an adult partner, was competent to enter into any agreement burdening himself. Proceeding hypothetically that clause 14 of the partnership deed dated December 19, 1974, had the effect of Prabhakar Gupta agreeing to bear the losses during the period of his minority, there was nothing illegal in it, because the obligation was accepted by him as a major partner competent to contract. It is not a case where an obligation was imposed on a minor or a minor had undertaken upon himself the obligation to bear losses arising to the partnership firm. In our opinion, the authorities below have completely lost sight of the fact that on December 19, 1974, Prabhakar Gupta was certainly competent to enter into an agreement undertaking to share the losses, assuming that, during the period of his minority, some losses accrued to the partnership firm. This proposition is too elementary to need an authority. We may, however, refer to the decision of the Bombay High Court in Commissioner of Income Tax Vs. R. Dwarkadas and Co., . The Bombay High Court held in the above-mentioned case that there was nothing in law to prevent a minor, after attaining majority, from undertaking responsibilities as a partner of a firm of which he had not been a partner until the date of such acceptance. The Bombay High Court observed that, on the date on which he was accepting the responsibilities and declaring himself as a full-fledged partner, he was a major and had agreed to be treated as such a full-fledged partner for the entire earlier period when he was only a minor. The Bombay High Court held that there was no infirmity in such an agreement. We respectfully agree with this

view. We, therefore, hold that the partnership deed dated December 19, 1974, did not suffer from any infirmity, even if it should be assumed for the purpose of an argument that Prabhakar Gupta had agreed to share losses that may accrue to the partnership firm during the period April 1, 1974, to October 30, 1974, when he was a minor.

5. We fail to see the relevance of the Revenue's argument that there was no operative deed during the period April 1, 1974, to October 30, 1974. On the facts above stated, it must be held that during this period, the earlier deed of partnership dated August 20, 1973, was operative. The partnership deed dated December 19, 1974, had the effect of altering the situation obtaining after Prabhakar Gupta attained majority on October 31, 1974. That partnership deed did not affect the operation of the earlier deed of partnership till October 30, 1974. This will have no relevance to the question whether the deed of partnership dated December 19, 1974, should be registered for purpose of Income Tax or not. Undoubtedly, the deed of partnership dated December 19, 1974, was executed during the accounting year relevant to the assessment year under consideration and the assessee asked for the registration of the firm evidenced by the deed of partnership dated December 19, 1974. u/s 185(1) of the Income Tax Act, 1961, the jurisdiction of the Income Tax Officer is limited to enquire into the genuineness of the firm and its constitution as specified in the instrument and if the Income Tax Officer is satisfied that there is or was during the previous year in existence a genuine firm with the constitution so specified, he is under an obligation to pass an order registering the firm for the assessment year. In the present case, there is no dispute that the firm evidenced by the deed dated December 19, 1974, was genuine. There is also no dispute about the fact that the firm in existence under the deed dated December 19, 1974, was in accordance with the constitution pacified in that deed. There is also no allegation that the assessee did not comply with the rules relating to the grant of registration, that is to say, filing an application in the prescribed form within time and in the manner prescribed. The Income tax Officer enters into a curious reasoning that, although the deed executed on December 19, 1974, among the partners is valid in law, it must be held to be invalid because clause 14 of the partnership deed, by implication, made the minor liable for losses during the period of his minority. On this reasoning, the Revenue contends that, inasmuch as Prabhakar Gupta, who was a minor up to October 30, 1974, was made liable for losses, the partnership deed, which is otherwise valid when it was executed on December 19, 1974, should be held to be invalid. We are unable to accept this curious reasoning. The deed of partnership executed on December 19, 1974, is perfectly valid in law as the parties to the deed were competent to contract and it is for the parties themselves to enter into whatever agreement they chose. Such a valid document cannot be rendered invalid by a circumlocutory process of reasoning.

5. We are equally unable to appreciate the Revenue's plea that clause 14 of the deed of partnership must be held to be retrospective in effect from April 1, 1974.

There is nothing in the said clause justifying the above inference. We may quote below clause 14 of the deed of partnership dated December 19, 1974 :

"That the accounts of this partnership as from April 1, 1974, shall be closed to profit and loss for the first time on March 31, 1975, and subsequently on 31st day of March every year. The net profits or loses so ascertained shall be shared and divided among the five partners in the following shares :

|                                             |                  |
|---------------------------------------------|------------------|
| Name of the partner                         | Extent of shares |
| 1. Dontamsetty Venkata Chalapathi Gupta ... | 12/100           |
| 2. Dontamsetty Narasimha Rao ...            | 22/100           |
| 3. Dontamsetty Ragha Gupta ...              | 22/100           |
| 4. Dontamsetty Sreeramachandra Gupta ...    | 22/100           |
| 5. Dontamsetty Prabhakar ...                | 22/100           |
| ----- Total ...                             | 100" -----       |

6. A perusal of the above clause would at once indicate that all that was stated therein was that accounts of the partnership from April 1, 1974, shall be closed to profit and loss for the first time on March 31, 1975, and the profits and losses ascertained and divided among the partners in the ratio specified therein. One cannot spell out that this clause had the effect of relating the provisions of the partnership deed back to April 1, 1974. The Revenue's plea regarding retrospective operation from April 1, 1974, is apparently based on the fact that the profits or losses arising from April 1, 1974, were required to be divided in the ratio specified in clause 14. This does not, in our opinion, make the partnership deed retrospective in its effect. We are unable to affirm the Tribunal's finding that the partnership deed must be deemed to have come into effect from April 1, 1974, by reason of clause 14 of the deed of partnership. We consider that the learned counsel for the assessee is right in his submission that the question of a minor bearing any losses for the period April 1, 1974, to October 30, 1974, does not arise particularly taking into consideration the provisions of clause 14 of the partnership deed, which we have extracted above. It is nobody's case that there was an agreement to close the account books on October 30, 1974, on which date Prabhakar Gupta ceased to be a minor. On the contrary, clause 14 of the partnership deed dated December 19, 1974, states that the accounts of the partnership shall be closed for the whole year on March 31, 1975, and the profits or losses ascertained on the closing of the accounts on March 31, 1975, shall be divided in the ratio specified in clause 14 of the deed of partnership. It may be true that in the gross receipts of a business day after day or from transaction to transaction lies embedded dormant profit or loss. On such dormant profit or loss undoubtedly taxable profits, if any, of the business will be computed, but dormant profits cannot be equated to profits charged to tax under the Income Tax Act. The concept of accrual of profits of a business involves their determination by the method of accounting at the end of the accounting year or any shorter period determined by the law. Profits do not accrue from day to day or even from month to month and have to be ascertained by a comparison of assets at two stated points. Unless the right to profits comes into existence, there is no accrual of profits and the destination of profits must be determined by the title thereto on the day on which they arise. In the case of a partnership,

where the accounts are to be made at stated intervals, the right of a partner to demand his share of the profits or the obligation to share any part of the losses does not arise until the contingency which, by operation of law or under a covenant of the partnership deed, gives rise to that right, has arisen. The above principles are fully settled by the decision of the Supreme Court in *Commissioner of Income Tax, Gujarat Vs. Ashokbhai Chimanbhai*, . The same principles flow from the decision of the Gujarat High Court in *Vinodkumar Ratilal Vs. Commissioner of Income Tax, Gujrat II*, and the decision of the Bombay High Court in *Arvind Bhogilal Vs. Commissioner of Income Tax, Bombay City II*, . While the learned standing counsel for the Revenue may be right in contending that, in the business transactions of every day is embedded some element of profit or loss, it would be wrong to say that a partner has a right to demand for the share of such profit or be obliged to bear his share of the loss until the accounts are closed as per the covenant entered into between the parties. We may refer to the decision of the Kerala High Court in *Commissioner of Income Tax Vs. P.M. Syed Mohammed Kannu and Co.*, . Dealing with an identical situation, the Kerala High Court held that clause 7 of the partnership deed under consideration in that case showed that it only provided for sharing of loss when accounts were closed at the end of the year. The minor in that case had attained majority on May 2, 1973, and the High Court held that it was open to the minor to agree to partake of losses ascertained by the end of 1973-74. The fact that, prior to May, 1973, during the accounting year, the partner was a minor was considered inconsequential by the Kerala High Court. We are in respectful agreement with the above view. It must, therefore, be held that the profits or losses accrue, for purposes of sharing by the partners, only on the date on which the partnership firm closed the accounts and not before. While this is broadly the legal position, it is more especially applicable in the present case, where there is a covenant in the partnership deed itself (vide clause 14) that the accounts shall be closed only on March 31, 1975, and not before. That being so, on the basis of the agreement itself, the right of any partner to demand his share of profit or the obligation of any partner to bear his share of loss did not arise until the accounts were closed on March 31, 1975. Undoubtedly, on March 31, 1975, when the legal rights sprang up, Prabhakar Gupta was liable to share the loss if the partnership should suffer loss, being an adult partner competent to share the loss on March 31, 1975. Even in the absence of an agreement to the above effect in the deed of partnership, the law itself is clear that profits or losses accrue or arise only when the accounts are closed to profit and loss. In this view, the question of the minor being obliged to bear any part of loss during the period April 1, 1974, to October 30, 1974, did not arise at all. In our opinion, the Tribunal was in error in thinking that, because of the alleged obligation imposed on the minor to bear losses relating to the period April 1, 1974, to October 30, 1974, the partnership deed in the present case was rendered invalid.

7. For the reasons aforesaid, we hold that the assessee-firm evidenced by the deed of partnership dated December 19, 1974, is bound to be registered u/s 185

of the Income Tax Act, 1961, and the Tribunal was in error in rejecting the assessee's claim for registration. We accordingly answer the question referred in the affirmative, that is to say, in favour of the assessee and against the Revenue. The Revenue shall pay the costs of the assessee. Advocate's fee Rs. 500.