

Gwalior Textiles Vs. Cit

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Court : Allahabad

Decided On : Sep-22-2004

Reported in : [2005]142TAXMAN184(All)

Appeal No. : IT Reference No. 3 of 1985 22 September 2004

Appellant : Gwalior Textiles

Respondent : Cit

Advocate for Pet/Ap. : Vikram Gulati, *for the Assessee* A.N. Mahajan, *for the Revenue*.

Judgement :

R.K. Agrawal, J.

At the instance of the assessee, the Income Tax Appellate Tribunal, Allahabad has referred the following three questions of law under section 256(1) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') for opinion to this court :

'1. Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was legally correct in holding that the supplementary partnership deed dated 25-1-1973 was not a genuine document till 27-11-1980 ?

2. Whether, the Income Tax Appellate Tribunal was legally correct in holding that there was no defect in the partnership deed dated 19-1-1973 in terms of section

185(2) of the Act ?

3. Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was legally correct in holding that the provisions of sub-section (1) of section 186 of the Act were applicable to the case ?'

2. Briefly stated, the facts giving rise to the present reference are as follows :

The present reference relate to the assessment years 1973-74 to 1977-78. The applicant is a firm. It has been constituted under a partnership deed dated 19-1-1973 and consists of six partners, namely, Hazi Jalaluddin, Ziauddin, Salahuddin, Alauddin, Mohd. Ansari and Km. Fatima Khatoon, besides two minors, namely, Abu Bakar and Irntiaz Ahmad, alleged to have been admitted to the benefit of the partnership. Clause (3) of the partnership deed dealt with the sharing of profits and losses amongst the partners. It reads as follows

'That the partners shall share the profits and losses arising out of the partnership business in the ratios mentioned below :

1.

Hazi Jalaluddin

0. 15 p. in a rupee

2.

Ziauddin

0. 10 p. in a rupee

3.

Salahuddin

0. 15 p. in a rupee

4.

Alauddin

0. 10 p. in a rupee

5.

Mohd. Ansari

0. 15 p. in a rupee

6.

Km. Fatima Khatoon

0. 15 p. in a rupee

7.

Abu Bakar

0. 10 p. in a rupee

8.

Imflaz Ahm ad

0. 10 p. in a rupee'

3. The applicant made an application for grant of registration in Form 11/11A of the Income Tax Rules, 1962 (hereinafter referred to as 'the Rules') on 27-3-1973 relating to the assessment year 1973-74. The Income Tax Officer found that the application had been filed within the prescribed period and that all the legal formalities have also been complied with. He accordingly passed an order under section 185(1)(a) of the Act granting registration. He also allowed renewal of registration for all subsequent years under section 184(7) of the Act. Subsequently, the Income Tax Officer noticed that, under clause (3) of the partnership deed, even the minors had been required to share in the losses and was, therefore, of the view that the applicant firm was not entitled to the benefit of

registration for the year 1973-74 and was consequently also not entitled for renewal of registration for all subsequent years. After issuing a show-cause notice on 16-10-1980 and considering the reply filed by the applicant, the Income Tax Officer cancelled the registration granted for the assessment year 1973-74 and also withdrew the renewal of registration for subsequent years. Feeling aggrieved, the applicant preferred separate appeal before the Appellate Assistant Commissioner of Income Tax who accepted the submissions that non-mention of the share in the losses to be suffered by the minors was a mere typographical or technical mistake which could not lead to cancellation or withdrawal of registration which had already been granted after careful consideration by the Income Tax Officer. He was also of the view that in any case it was a defect in the partnership deed which could be rectified under section 185(2) of the Act within a period of one month of the date of its intimation and since the notice was issued on 16-10-1980, rectification made on 27-11-1980 through the supplementary partnership deed was well within time. He, therefore, cancelled the order of the income Tax Officer passed under section 186(1) of the Act and restored the original order granting registration and renewal of registration for different years.

4. Feeling aggrieved, the revenue preferred an appeal before the Tribunal. The Tribunal had held that supplementary partnership deed filed before the Income Tax Officer on 27-11-1980 was not a genuine document till 27-11-1980 and, therefore, it could not have removed the defect, if at all there was one, in the partnership deed dated 19-1-1973 during the previous year relevant to the assessment year in question. The Tribunal while allowing the appeal, restored the order passed by the Income Tax officer.

5. It may be mentioned here that after the Income Tax Officer had issued a show-cause notice to the applicant on 16-10-1980 requiring it to show as to why the registration already granted be not withdrawn. The applicant while justifying the mention of the shares of the minors in the losses of the partnership deed dated 19-1-1973, to be a mere technical or typographical error, had submitted that the mistake had already been rectified through a supplementary partnership deed dated 25-1-1973 in which the losses were to be shared by the adult partners in the following proportion

1.

Hazi Jalaluddin

.25 p. in a rupee

2.

Ziauddin

.10 p. in a rupee

3.

Salahuddin

.15 p. in a rupee

4.

Alauddin

. 10 p. in a rupee

5.

Mohd. Ansari

.25 p. in a rupee

6.

Km. Fatima Khatoon

.15 p. in a rupee

7.

Abu Bakar

-

8.

Irntiaz Ahmad

-

6. We have heard Sri Vikram Gulati, learned counsel for the applicant, and Sri A.N. Mahajan, learned Standing counsel appearing for the revenue.

7. The learned counsel for the applicant submitted that in the original partnership deed dated 19-1-1973, it was specifically mentioned that the two minors, namely, Abu Bakar and Irntiaz Ahmad, have been admitted with the mutual consent of the partners to the benefits of the partnership. He further submitted that in clause (3) of the partnership deed dated 19-1-1973 on account of typographical and technical error, the profits and losses arising out of the partnership business was specified in which the two minors were also allocated losses, which mistake was rectified through a supplementary partnership deed dated 25-1-1973 and, therefore, the applicant firm was entitled to and had rightly been granted registration and renewal. The IncomeTax Officer as also the Tribunal to have erred in cancelling the registration and withdrawing the renewal. In support of his aforesaid submissions, he relied upon the following decisions :

(i) Laxmi Trading Co. v. CIT (1966) 62 ITR 770 (All);

(ii) Parekh WadilalJaganbhai v. CIT : [1967]63ITR485(SC)

(iii) Hiralal Jagannath Prasad v. CIT : [1967]66ITR293(All)

(iv) CIT v. Hyderabad Stone Depot : [1977]109ITR686(AP)

(v) CIT v. Hari Ram Khanna : [1979]116ITR886(All)

(vi) CIT v. Krishna Steels (1980) 124 ITR 471 and

(vii) CIT v. Agrawal Refrigeration : [1994]210ITR215(All)

8. Shri A.N. Mahajan, the learned standing counsel for the revenue, submitted that in the original partnership deed dated 19-1-1973 the two minors have also been made to suffer the losses in the same ratio as they were entitled to share the profits. The ratio of the profits and losses which the adult partners and the minors were to share, was unequal and as minors have also been made to suffer the losses, the partnership was not a valid partnership under law and, therefore, could not have been granted registration and consequently was not entitled for renewal.

9. He further submitted that the supplementary partnership deed dated 25-1-1973 has been held by the Tribunal to be not a genuine document till 27-11-1980. According to him, if the supplementary partnership deed was in existence on 25-1-1973, as claimed by the applicant, there was no plausible explanation as to why the said supplementary partnership deed was not filed before the Income Tax Officer at the time of claiming registration, which application was filed on 27-3-1973, i.e., about two months thereafter. He, thus, submitted that the supplementary partnership deed had been written/executed only after the show-cause notice dated 16-10-1980 had been issued by the Income Tax Officer calling upon the applicant to show cause as to why the registration already granted be not withdrawn. He, thus, submitted that the Tribunal had rightly upheld the order of the Income Tax Officer cancelling the registration and withdrawing the renewal or subsequent assessment years.

10. Having heard the learned counsel for the parties, we find that it is not in dispute that under clause (3) of the partnership deed dated 19-1-1973, already reproduced hercinbefore, the partners were to share the profits and losses arising out of the partnership business in the ratio mentioned therein. It had made the two minors also to share the profits and losses at the rate of 10 paise in a rupee. The application for grant of registration in form 11/11A of the Rules was filed on 27-3-1973. In the supplementary partnership deed alleged to have been executed on 25-1-1973, the losses to be shared by the adult partners have been varied and the two minors have been excluded therefrom. No convincing explanation has been given by the applicant as to why the supplementary partnership deed which is said to have been executed on 25-1-1973 was not filed alongwith the application in Form 11/11A on 27-3-1973. Moreover the alleged supplementary partnership deed

had not seen the light of the day till 27-11-1980 when it was filed in reply to the show-cause notice dated 16-10-1980. Thus, the inference drawn by the Tribunal that the supplementary partnership deed dated 215-1-1973 was not a genuine document till 27-11-1980, i.e., when it was filed before the Income Tax Officer in response to the show-cause notice dated 16-10-1980, does not suffer from any legal infirmity.

11. 'To err is human' is an old but a very sane saying. Errors, even in documents and deeds, are not always fatal to the avowed cause. If crept in, they can be put right by supplementary or rectification deeds. As a result of the supplementary deed, the infirmity in the original deed may be deemed to have been wiped out on and from the date of execution of the supplementary deed, as held in CIT v. Shantilal Vrajilal & Chandulal Dayalal : [1957]31ITR903(Bom) N.T Patel & Co. v. CIT : [1961]42ITR224(SC) CIT v. R. Dwarkadas & Co. : [1971]80ITR283(Bom) CIT v. Ram Saran Inder Singh and Rajendra Trading Co. v. CIT : [1976]104ITR39(Bom) . Thus, a rectification deed executed after close of accounting year cannot affect the original deed from an earlier date falling within the accounting year as held in Singh Bros. & Co. v. CIT . In this view of the matter, the supplementary partnership deed has rightly been held to be effective from 27-11-1980 and would not be of any advantage or benefit to the applicant during the assessment years in question.

12. In the case of Laxmi Trading Co. (supra) this court has held that even though in the case of a firm in which some minors are admitted to the benefits of the partnership without any liability to share the losses, the shares of the partners in the profits would not be the same as their shares in the loss, an application for registration of such a firm cannot be refused merely because shares in profits of all the partners including those admitted merely to the benefits of the partnership are specified and there is no separate specification of shares of the major partners in the losses.

13. In the case of Parekh Wadilal Jivanbhai (supra), the Apex Court was considering the question as to whether a partnership firm which was constituted under a deed of partnership dated 19-3-1950 and had three partners, each one

having equal 1/3rd share in the partnership firm, was entitled for registration or not. The Apex Court after noticing that in all the applications for registration made by the firm under section 26A of the Indian Income Tax Act, 1922 the three partners had been shown to share the profit equally and the profit had been proportioned equally amongst the three partners in the books of account, there was specification of individual share of the partners in the profits within the meaning of section 26A of the said Act and the firm was entitled to registration for the assessment year in question. The Apex Court had applied the principle laid by it in the case of *Kylasa Sarabhaiah v. CIT* : [1965]56ITR219(SC) .

14. In the case of *Hiralal Jagannath Prasad* (supra), this court has held that the omission to specify in a partnership deed the share of the partners in the losses will not make the deed invalid so as to prevent the firm from being registered under section 26A of the Indian Income Tax Act, 1922. In the aforesaid case, this court had interpreted clause (3) of the partnership deed, which reads as follows :

'3. That in the partnership business the share of the first party shall be 1/7th and in the same way the share of each of the other partners shall be 1/7th and each party shall be entitled to get the profits and be liable to bear the losses according to his share and the parties have admitted Ram Prasad, minor son of Hiraial Sahu, the first party, to the benefit of partnership according to section 30 of the Indian Partnership Act and he also will get 1/7th share in the profits of the firm.'

The court followed its earlier decision in the case of *Laxmi Trading Co.* (supra) and had held that merely because the share of losses is not specified, it will not make the deed invalid.

15. In the case of *Hyderabad Stone Depot* (supra), the Full Bench of the Andhra Pradesh High Court has held that there is no rule which compels the partners to always take 100 paise or 16 annas as a unit and then determine the shares of the partners in the losses. The parties are free to take any digit or figure as a unit and specify the shares of the major partners in the losses in that unit. As long as the partnership deed specifies the shares of the partners in profit and loss, whatever may be the method by which that is specified, it cannot be argued that the deed does not specify the shares of the partners in profit and loss as required by section

26A of the Act. As long as the shares can be worked out according to the specification made in the deed the registration cannot be refused on the ground that the deed omits to specify the share in profit or loss.

16. In the case of Hari Ram Khanna (supra), this Court has held that where the application for registration was made in time and in proper form and complied with all the requisite formalities including the declaration which is required to be made that the profits of the firm will be divided or credited in accordance with the shares specified in the partnership deed and the division occurred subsequently which was on account of inadvertent fault of the Accountant, it cannot be said that the firm was not genuine, the division being negligible.

17. In the case of Krishna Steels (supra), this court has held as follows

'We agree that the registration of a firm under the Income Tax Act is not a general right. It is privilege given to the firm in order that the individual partners may get the benefit of the lower rate of assessment in addition to the tax payable by the firm directly on its total income. The income of the firm would be apportioned amongst the partners and their share income would be included in their total income and assessed to tax accordingly. The deed of partnership sets out the share to which each partner is entitled. The department is certainly entitled to enquire whether the profit-sharing ratio as specified in the deed is in fact adhered to. The profit actually distributed to the partner determines the rate at which he is to be assessed. In our opinion, therefore, if before the completion of the assessment distribution is actually made, the purpose of the Act would be fulfilled, particular when there is nothing to cast any doubt on the genuineness of the firm. We are, therefore, of the opinion that if it is stated in the application for registration that the profit/loss would be divided amongst the partners and if before the completion of the assessment such division is actually made, registration cannot be refused, if the other requirements stand duly satisfied. As for the mode of distribution of profit/loss there is no particular provision made in the Act or the rules and, therefore, if it is made in a manner which may indicate that the division has been made in accordance with the shares specified in the partnership deed, we do not think that any fault can be found with such division. For these reasons,

therefore, we agree with the view taken by the Tribunal'. (p. 54)

18. In the case of Agrawal Refrigeration (supra), this court has held as follows :

'On a consideration of sections 184 to 186 of the Income Tax Act and the scheme provided thereunder, it is manifest that where a firm is genuine and complies with the requirements of those sections and the Rules framed thereunder, it is incumbent upon the Income Tax Officer to grant registration to the firm. The mistake committed by the munist in allocating the profits was capable of being corrected and reconciled in terms of the partnership agreement. Indeed, this was done in the instant case before the assessment was made. As shown earlier, failure to divide the profits amongst the partners in accordance with the terms of the partnership deed did not itself disentitle the firm to be registered so long the partnership was evidenced by an instrument of partnership and there was no reason to doubt the genuineness of the partnership deed and the other conditions had been complied with (p, 217)

The cases relied upon by the applicant are not applicable to the facts of the present case inasmuch as in all these cases, the partners were to share the losses equally without there being any specification. It is not a case where the minors who have been admitted to the benefit of the partnership, have been made to share the losses also. Further, it is not a case where there has been any inadvertent mistake in distribution of profits and losses otherwise than specified in the partnership deed.

19. In the case of Mandyala Govindp & Co. v. CIT : [1976]102ITR1(SC) the Apex Court has held that where in the profits the partners had unequal share, i.e., 31%, 23% and 23% and a minor was admitted to the benefit of the partnership with a share of 23% in the profit and there was no clause in the deed of partnership specifying the proportion of three adult partners to share the losses, there could be no presumption that the losses were to be shared equally and having regard to the scope of section 13(b) of the Partnership Act, the section had no application. The Apex Court had further held that the rule that where the shares in the profits were unequal, the losses must be shared in the same proportion as the profit, did not apply because even if the adult partners were to bear the losses in proportion to

their respective shares in the profits, there was no means of ascertaining how the amount of loss in the minor's share was to be apportioned, therefore, the firm was not entitled to registration under section 26A of the Indian Income Tax Act, 1922.

20. The Bombay High Court in the case of CIT v. Bhai Chandra Textile Mills : [1986]161ITR129(Bom) has taken a similar view.

21. A Full Bench of the Rajasthan High Court in the case of Metharam Lekhumal v. CIT (1988) 169 ITR 1941 has held as follows :

'Where a minor is admitted to the benefits of a partnership, the document evidencing the contract must specify expressly or at least by necessary implication the proportion in which the adult partners are to share the losses, if any, of the firm. The mere mention of the shares of the adult partners and the minor in the profits of the firm cannot provide any basis for drawing any inference about the proportion in which the adult partners have to share the losses of the firm. For this reason, in the absence of any provision in the instrument of partnership evidencing the contract of partnership for sharing of losses by the adult partners where a minor has been admitted to the benefits of the partnership and the shares indicated are merely for sharing the profits, the firm cannot be granted registration treating it as genuine.' (p. 194)

22. In the case of Progressive Financers v. CIT : [1997]224ITR595(SC) , the Apex Court has held that the assessing officer cannot reject an application for registration of a firm merely because, in the deed of partnership, the shares of the partners are not expressly specified. The assessing officer will have to construe the instrument of partnership as a whole, and if reasonably the shares of the partners in profits and losses can be ascertained, accept it as genuine for the purpose of registration. Even if the shares of the partners were not expressly specified in the instrument of partnership but they could be ascertained by the Income Tax Officer from the application and the required information supplied therewith, then the requirements of the law could be said to have been satisfied. The Honble Supreme Court further held that where the shares of the partners in the profits of the firm are unequal, the losses must be shared in the same proportion as the profits, if there is no agreement as to how the losses are to be

apportioned.

23. Applying the principle laid down by the Apex Court in the case of Progressive Financiers (*supra*) to the facts of the present case, we find that where there is an agreement specifying that the losses are to be apportioned and the minors have also been made to share the losses. It is well settled that under the Partnership Act, a minor cannot be made to suffer the losses. Thus, the partnership was not a valid partnership in the eyes of law. It is not a case of any defect in the partnership deed dated 19-1-1973 in terms of section 185(2) of the Act nor could be rectified under section 186(1) of the Act.

24. In view of the foregoing discussion, we answer all the three questions of law, referred to us, in the affirmative, i.e., in favour of the revenue and against the assessee. However, there shall be no order as to costs.

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