

Before Ashok Bhan & N.K. Agrawal, JJ

The Commissioner of Income Tax, Patiala,—*Petitioner*

versus

M/s Jagdish Chand Walia & Co. Ludhiana,—*Respondent*

I.T.R. No. 93 of 1984

29th September, 1997

Income Tax Act, 1961—S.185(1)(a)—Indian Partnership Act, 1932—S.12—Punjab Excise Act, 1914—Ss. 24 & 26—Punjab Liquor Licence Rules, 1956—Rls. 6 & 7—Partnership firm—grant of Registration Certificate—Firm dealing in liquor trade—Licence granted in favour of two partners inducted—Their names not included in licence—Whether such firm entitled to registration.

All the partners of partnership firm have authority under Section 12 of the Indian Partnership Act to take part in business. Every partner has duty to attend business diligently. It cannot be said that the actual physical handling of liquor by a non-licensee partner was necessary so as to invalidate his entry in the firm. It is also clear from Rule 7 of the Excise Rules that in the case of partnership firm securing a liquor licence all the partners of the firm must be named in the licence. In case the existing partners of a firm intend to admit a new partner, they must file an application in writing before the competent authority who may grant or renew the licence entering the names of the new partners.

(Paras 7 & 17)

Further held, that a partnership firm cannot be constituted by a licensee with the help of strangers unless he obtained the requisite prior approval from the competent excise authority. It may further be noticed that sub rule (26) of Rule 37 requires the endorsement of the names of all persons engaged in the business on the licence. In this situation, the constitution of the firm in the case before us is found to be in contravention of Rule 7 and rule 37(26) of the Punjab Liquor License Rules, 1956.

(Para 49)

Further held, that since the names of all the partners constituting the firm had not been entered in the liquor licence, the firm was not entitled to a registration certificate for the relevant assessment year.

(Para 3)

B.S. Gupta, Senior Advocate with Mr. Sanjay Bansal,
Advocate, *for the Petitioner.*

A.K. Mittal, Advocate, *for the Respondent.*

JUDGMENT

N.K. AGRAWAL, J.

(1) The following question has been referred to this Court by the Income-tax Appellate Tribunal, Chandigarh (for short "the Tribunal") at the instance of the department under Section 256(1) of the Income-tax Act, 1961 (for short, "the Act") :—

"Whether on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was right in law in cancelling the order passed by the Commissioner of Income-tax under section 263 of the Income-Tax Act, 1961."

(2) The assessee firm was engaged in the business of sale of liquor under a licence. The Income Tax Officer (for short, "the ITO") under Section 185(1)(a) of the Act granted registration to the firm, M/s Jagdish Chand Walia and Company, Ludhiana for the assessment year 1977-78 on the basis of the partnership deed filed on 31st March, 1977. The Commissioner of Income-tax, however, cancelled that order under Section 263 of the Act, holding that the order of the ITO was erroneous and prejudicial to the interests of the revenue. The Commissioner noticed that licences to sell liquor had been actually granted by the Punjab Government in the names of three persons, Jagdish Chand Walia, Amarjit Walia and Harish Chand Walia. The firm was, however, constituted by four partners. The name of 4th person, Sudhir Walia, was not entered in the licence. Therefore, the firm was held to be not legally constituted and not entitled to registration under the Act. The Commissioner took the view that the licences to sell liquor could not be exploited by four persons, if those were granted in favour of three persons only. The Commissioner held that any contravention of the Punjab Excise Act and the rules framed thereunder would render the firm illegal. Non-approval of the change in the constitution of the firm by the excise authority would amount to a violation of the excise law. Since L-2 licences had been obtained individually by three persons on 18th March, 1976, the subsequent addition of the 4th person to the business was said to be not permissible without sanction from the concerned excise authority. The assessee went

in appeal against the order of the Commissioner before the Tribunal and succeeded. The Tribunal took the view that there was no material on record to show that the rules framed under the Punjab Excise Act had been violated.

(3) The basic question which arises is whether the genuineness of the firm running the liquor business was rightly discarded and rejected by the I.T.O. on the ground that the names of all the partners constituting the firm had not been entered in the liquor licence.

(4) Section 185 of the Act required that the I.T.O. on receipt of an application for the registration of a firm, shall enquire into the genuineness of the firm and its constitution as specified in the instrument of partnership. If he is satisfied that there was, during the previous year, in existence a genuine firm with the constitution so specified, he shall pass an order in writing, registering the firm for that assessment year. If he is not satisfied, he shall pass an order in writing, refusing to register the firm. It cannot be said as a general proposition of law that Section 185 is merely a procedural provision. It requires the I.T.O. to make an enquiry into the genuineness of the firm and its constitution.

(5) Partnership is the relation between the persons who had agreed to share the profit 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 persons and collectively a firm. to constitute a partnership, there must be three elements: (i) there must be an agreement entered into by two or more persons; (ii) the agreement must be to share the profit of a business; and (iii) the business must be carried on by all or any of those persons acting for all. One of the essential conditions of a partnership firm is that every partner must have dominion over the property by virtue of the fact that he is a partner. Carrying on of a business is essential for the existence of a partnership. In other words, the actual existence of a business carried on by the partners is essential to constitute partnership.

(6) Section 4 of the Indian Partnership Act, 1932 requires that it is not necessary that the business should be infact carried on by all the partners and that all of them should participate in running the same. So long as the business is being carried on by any party on behalf of all the parties to the agreement, with a view to sharing its profits, the provisions of Section 4 of the Indian Partnership Act, 1932 will apply.

(7) Section 12 of the said Act specifies the provisions in respect of the conduct of the business of the partnership. It reads as under:—

“SECTION 12:

The conduct of the business :—

Subject to contract between the partners:—

- (a) every partner has a right to take part in the conduct of the business;
- (b) Every partner is bound to attend diligently to his duties in the conduct of the business;
- (c) any difference arising as to ordinary matters connected with the business may be decided by a majority of the partners, and every partner shall have the right to express his opinion, before the matter is decided, but no change may be made in the nature of the business without the consent of all the partners; and
- (d) every partner has a right to have access to and to inspect and copy any of the books of the firm.”

(8) It is manifest from the clauses of Section 12 that, subject to the contract, every partner has a right to take part in the conduct of the business and every partner has also an obligation to attend to his duties in the conduct of the business. Similarly, every partner can have access to the books of the firm.

(9) If a partnership has been constituted to run liquor business, it would empower every partner of the partnership firm to take part in the business. If the name of a partner is not entered in the licence, so as to empower him to run the business as a licensee, the constitution of the firm comes under a cloud inasmuch as a person not empowered as a licensee has been made entitled under the contract of partnership to take part in the business of liquor.

(10) For the grant of registration to a firm, the Assessing Officer has to satisfy himself that the partnership is not only genuine but also a valid one. The validity of a partnership is to be decided with reference to the express provisions of the Indian Partnership Act and other laws. Even if a partnership is valid in law but it is not found to be genuine, the firm would not be entitled

to registration.

(11) Section 17 of the Punjab Excise Act, 1914 empowers the State Government to prohibit the import or export of any intoxicant into or from Punjab or prohibit its transport. Under Section 19 of the said Act, passes for the import export or transport of intoxicant are to be granted by the Collector. Section 24 lays down the conditions for the possession of intoxicant. Since it is relevant, it would be necessary to read Section 24:—

“SECTION 24:—

Possession of Intoxicant:—

- (1) No person shall have in his possession any quantity of any intoxicant in excess of such quantity as the State Government has, under Section 5, declared to be the limit of retail sale, except under the authority and in accordance with the terms and conditions of:—
 - (a) a licence for the manufacture sale or supply of such article; or
 - (b) in the case of intoxicating drugs, a licence for the cultivation or collection of the plants from which such drugs were produced: or

Exceptions; (2) Sub-section (1) shall not apply to:—

- (a) any intoxicant in the possession of any excise officer, common carrier or warehouseman as such; or
- (3) A licensed vendor shall not have in his possession at any place than that authorised by his license, any quantity of any intoxicant in excess of such quantity as the State Government has under Section 5 declared to be the limit of sale by retail, except under a permit granted by the Collector in that behalf.
- (4) Prohibition and restriction of possession of intoxicants in certain cases:

Notwithstanding anything contained in the foregoing sub-sections, the State Government may by notification prohibit the possession of any intoxicant, or restrict such possession by such conditions as it may prescribe.”

(12) It would be, thus, apparent that a person may possess any quantity of any intoxicant under the authority and in accordance with the terms and conditions of a licence. If a person is not a licensee, he cannot possess liquor.

(13) Section 26 relates to the sale of intoxicant and it reads as under:—

“SECTION 26:—

Sale of intoxicants:—

No liquor shall be bottled for sale and no intoxicant shall be sold, except under the authority and subject to the terms and conditions of a license granted in that behalf, provided that:—

- (1) a person licensed under Section 20 to cultivate the hemp plant may sell without a license those portions of the plant from which any intoxicating drug can be manufactured to any person licensed under this Act to deal in the same or to any officer whom the Financial Commissioner may appoint in this behalf;
- (2) a person having the right to the ‘tari’ drawn from any tree may sell the same without a license to a person licensed to manufacture or sell ‘tari’ under this Act;
- (3) on such conditions as the Financial Commissioner may determine, a license for sale under the excise law for the time being in force in other parts of the whole of Indian except part B. States may be deemed to be a license granted in that behalf under this Act,
- (4) nothing in this section applies to the sale of any foreign liquor lawfully procured by any person for his private use and sold by him or on his behalf or on behalf of his representatives in interest upon his quitting a station or after his decease.”

(14) It is again clear from the aforesaid Section that no person can sell liquor except under the authority of licence.

(15) Rule 4 of the Punjab Liquor License Rules, 1956 lays down that a licence may be granted to an individual, a body

incorporated under the Indian Companies Act, a Society registered under the Punjab Cooperative Societies Act, 1961, a partnership firm, a Hindu undivided family or a Government Department.

(16) Rules 6 and 7 of the aforesaid rules are relevant for the purposes of the present controversy before us and read as under:—

“RULE 6 :

When a license is granted to a partnership or firm or not incorporated under any Act, all the individuals comprising the partnership or firm should specified on the license.

RULE 7 :

On the application in writing of all the original partners, a partner may at any time be added, in case of renewable licenses, by the authority competent to renew the license and in case of licenses granted by auction by the Collector, provided the proposed partner is eligible under the Punjab Intoxicants License and Sale Orders or these rules, in which case he shall be responsible for all obligations incurred or to be incurred under the license during the period of its currency as if it had originally been granted or renewed in his name.”

(17) It would, thus, appear that in the case of a partnership firm securing a liquor licence, all the partners of the firm must be named in the licence. In case the existing partners of a firm intend to admit a new partner, they must file an application in writing before the competent excise authority who may grant or renew the licence, entering the names of the new partners. It is necessary that the new partner should be eligible under the Punjab Intoxicant License and Sales Orders. If the name of the proposed partner is added under the orders of the competent authority or the Collector, such a partner shall be responsible for all the obligations arising from the licence.

(18) Shri Sanjay Bansal, counsel for the department, has argued that Rule 7 specifically requires that any new partner may be added only on an application in writing filed before the authority competent to grant or to renew the licence. Shri Bansal has further argued that Rule 7 would equally apply to an individual holding a licence if such an individual intended to constitute a partnership firm and wanted certain more persons to run the business as

partners. Though Rule 7 apparently appears to be referring to the original partners only for the purpose of addition of a new partner to the firm, the intention and object of Rule 7 must be kept in view and the rule must be invoked in all cases where a new partner is intended to be added either by individual licensee or by the existing partners holding a licence or licences.

(19) Shri Ajay Mittal, counsel for the assessee, has, on the other hand, controverted the plea of the department with the contention that Rule 7 of the Punjab Liquor License Rules specifically and expressly refers to the original partners seeking to add a new partner to the firm. In such a situation, Rule 7 is said to be applicable only to a case where the existing partners of a partnership firm intend to add a new partner and this rule would not be attracted where an individual holding a liquor licence intended to constitute a firm with the help of new partners.

(20) On a close examination of Rule 7 of Punjab Liquor License Rules, 1956, the said rule appears to be attracted to a situation where the original licensee intended to constitute or reconstitute a firm thereby involving more individuals in the conduct of his business. If Rule 7 is held to be applicable only to an existing partnership firm seeking to add new partners, the rule would obviously become wholly illogical and incomplete. The intent and object of the rule are manifestly to prevent a new partner in the running of a liquor business, unless such a partner is added with the approval of the competent authority. If an individual running a business and adding a new partner is excluded from the purview of Rule 7, the scheme in the rule would become totally irrelevant. It would be, therefore, on a harmonious construction of the rule, appropriate to hold that Rule 7 of the Punjab Liquor License Rules, 1956, is attracted to a situation where a licensee either running his business in liquor as an individual or as a partnership firm, seeks to add a new partner to the running of his business. Such a construction of the rule would make it rational and also workable.

(21) Rule 7 of the Punjab Liquor License Rules, 1956, thus, requires a licensee to include a new partner in this business with the permission of the competent authority only. If this is not so done, he cannot be said to have the right to add a new partner to his business run as a proprietorship concern or as a partnership firm.

(22) Shri Ajay Mittal, counsel for the assessee, has further argued that Rule 7 did not require, in mandatory terms, that a

new partner can be added only after previous permission or sanction from the competent authority. It only requires the original licensees to make an application in writing to the competent authority for adding a new partner. Since the rule does not lay down any prohibition against the running of a business with the addition of a new partners to the firm, there is no bar to a change in the constitution of the firm either as a proprietorship business or as a partnership firm. Shri Mittal has further argued that there is no provision specifying any penalty for the breach of Rule 7.

(23) On a careful examination of Rule 7 of the Punjab Liquor License Rules, 1956, it would appear that it does require a person holding a liquor licence to make an application in writing to the competent authority seeking permission to add a new partner to his business. It would not be correct to accept the view that Rule 7 did not specifically and explicitly lay down a requirement of law. The rule, in specific terms, enjoins upon the original licensee to file an application, seeking permission from the competent authority to add a partner to his business. It may also be noticed that Section 61 of the Punjab Excise Act, 1914 specifies the penalty for unlawful import, export, transport, manufacture or possession of any intoxicant. A person who collects or possesses any intoxicant in contravention of any section of the Punjab Excise Act or of any rule, notification, order, licence, permit or pass granted under the said Act shall be punishable with imprisonment for a term which may extend to three years and with fine upto Rs. 2,000. Therefore, the argument of Sh. Mittal that breach of Rule 7 has not been made punishable does not have any merit. Section 61, in broader terms, makes any violation of the Punjab Excise Act or the rules framed thereunder, a punishable offence. Therefore, in our view, Rule 7 of the Punjab Liquor License Rules, 1956 cannot be said to be a rule with no mandatory authority or inviting no penalty for its breach.

(24) The next controversy which is required to be considered, relates to the plea whether a partnership firm constituted in breach of Rule 7 could be treated to be an ingenuine firm. As has been seen earlier, the I.T.O. has an authority to consider whether a firm running liquor business had really and genuinely come into existence. The question is if the firm is not valid by reason of having authorised no-licensee-partners to run the business of liquor, can be partnership be declared as not genuine.

(25) Shri Ajay Mittal, counsel for the assessee, has argued that the new partner added to the firm did not handle the liquor

and, thus, he did not act as the person in possession of an intoxicant or selling the same. It is stated that there was no material on record to show that the non-licensee partner was found to be possessing or selling liquor on behalf of the licensees. The new partner had been added only to bring finance and did not actively participate in the conduct of the business.

(26) It has been seen that all the partners of a partnership firm have the authority under Section 12 of the Indian Partnership Act to take part in the conduct of the business of the firm. Every partner has also a duty to attend to the business of the firm diligently. In this context, it cannot be said that the actual physical handling of liquor by a non-licensee partner was necessary so as to invalidate his entry in the firm. Section 9 of the Indian Partnership Act further lays down that the partners are bound to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other and to render true accounts and full information of all things affecting the firm to any partner or his legal representative. It would, thus, appear that the new partner, who was admitted by the existing licensees, had the right to carry on the business of the firm. There is nothing on record to show that, under the partnership agreement, the new partner was debarred from taking part in the conduct of the business and he was introduced to bring finance only.

(27) During the course of hearing, S/Shri J.K. Sibal and Mohan Jain, Advocates, who are counsel for other assesseees in similar other matters, also advanced arguments. Shri Sibal's main plea was that Sections 24 and 26 of the Punjab Excise Act prohibited a person from possessing or selling any intoxicant without a licence. A person who is made a partner in a firm engaged in the business of liquor cannot be said to possess or sell liquor unless there was some material on record to show the same. Shri Sibal has argued that a presumption cannot be raised against a non-licensee partner that he engaged himself actively in the conduct of the business. A partner may be a financing partner or a sleeping partner in a firm and such a partner is not required to participate in the business. The next argument of Shri Sibal is that the specific provision in the State enactment shall govern the rights of the assessee to constitute a firm with strangers. If there was no specific bar in the excise law of a State against the running of business by a partnership firm with strangers, the constitution of such a firm cannot be said to be invalid or illegal.

(28) Shri Mohan Jain, learned counsel, has also put forwarded his contentions on similar lines as were projected by Shri Ajay Mittal and Shri J.K. Sibal, Advocates. Shri Mohan Jain has laid stress on the proposition that unless a condition was specified in the licence prohibiting the constitution of a firm with strangers, there could not arise a conclusion that the firm was not authorised to do business in liquor. Shri Jain has argued that a licensee is bound by the terms and conditions of the licence do not require a licensee to comply with a specific excise rule, the licensee cannot be held liable. Shri Jain has, in the course of his argument, drawn our attention to a printed copy of the excise licence prepared by the Excise and Taxation Department, Punjab, for the issuance of licence. In this printed proforma of the licence, the following condition has been specified :—

“This licence is granted subject to the provision of the Punjab Liquor Licence Rules, 1956 as amended from time to time and the supplementary conditions.”

(29) The argument of Shri Mohan Jain that a licensee would be bound only by the conditions of the licence does not carry any substance inasmuch as the rules framed in this behalf cannot be said to be in-effective or unenforcable only because all the rules do not form part of the conditions of the licence. Moreover, if the licence is granted subject to the provisions of the rules, the argument of Sh. Mohan Jain loses its base in its entirety. The licence for running the business in liquor may be issued with specifying therein that the licence shall be governed by the rules but that would not mean that the licensee has not to act in accordance with the rules and he was free to violate the rules. The rules are framed by the Government under the delegated powers conferred by the legislature. The Punjab Liquor License Rules, 1956 have been framed by the State Government in exercise of the powers under Section 58 of the Punjab Excise Act. Therefore, the licence granted to a licensee subject to the provisions of the Punjab liquor License Rules, 1956 shall be treated to be a licence governed by those rules. Consequently, any prohibition contained in the rules shall be applicable to the licensee. It may be noticed that sub-rule (26) of Rule 37 prohibits a licensee from allowing any person to conduct sales in his behalf unless the name of such person has been previously submitted to the Collector for approval and endorsed by him on the licence. Thus, Rule 7 and Rule 37 (26) governed the conduct of business by a licensee and a non-licensee partner cannot be permitted to conduct business on behalf of the firm.

(30) The question about the business in excisable goods was examined by the Patna High Court in *Md. Warasat Hussain vs. Commissioner of Income-tax, Bihar and Orissa*, (1). Two brothers held excise licences in their own names but the business of the licensed shops was carried on jointly. One brother died and, after his death, the firm was reconstituted. Two sons of the deceased brother were brought in as the partners. Thereafter, the second brother also died and in his place his two sons became the partners of the firm. The firm was later on again reconstituted. The I.T.O. refused the renewal of the registration on the ground that the partnership was illegal and it violated the provisions of the Bihar and Orissa Excise Act, 1915 and the rules framed thereunder. The Appellate Assistant Commissioner took the view in assessee's appeal that the licenses stood in the individual names of four partners whereas six partners carried on the business in wine. This amounted to transfer of the licenses which was in contravention of the provisions of the Bihar and Orissa Excise Act, 1915. The Appellate Tribunal also up-held the order of the I.T.O. The High Court, however, reached the conclusion that the formation of partnership did not contravene any of the provisions of the Bihar and Orissa Excise Act and, therefore, was not invalid in law. It would be, thus, seen that the reconstitution of the firm was held to be valid inasmuch as no violation of any provision of the relevant excise law was noticed by the Court.

(31) A question about the registration of a firm running a liquor business was examined by the Full Bench of the Allahabad High Court in *P.C. Kapoor vs. Commissioner of Income-tax, Lucknow*, (2). The firm running the business in liquor consisted of five partners. The licence was issued in the names of Badri Parshad and Debi Parshad. Names of Shyam Kishore, Nawal Kishore, Prem Chand and Om Parkash, the new partners, alongwith Badri parshad and Laxman Parshad were entered in the licence as salesmen. For running the country liquor business, a licence had been thus obtained in the names of two persons and some more persons were shows as salesmen. The I.T.O., declined to grant registration to the firm but the Appellate Assistant Commissioner took the view that the partnership in question was not illegal because there was no provision in the U.P. Excise Act, prohibiting the partnership from carrying on liquor business. Rule 337 of the U.P. Excise Manual prohibited the transfer or sub-lease or

1. 82 I.T.R. 718

2. 90 I.T.R. 172

partnership of excise licence without the prior approval of the Excise commissioner. It was noticed that the activity of sale was carried on only by such partners in whose names the licences stood or whose names were incorporated in the licence as salesmen. It was further seen that the provisions of the U.P. Excise Manual were in the nature of instructions and had not been published in the official gazetted. It was, therefore, held that the instructions were merely executive instructions issued to the District Excise Officer and they did not have the force of law. It could not, therefore, be said that the act of entering into partnership, with regard to a licence issued under the Excise Act, was prohibited by law. It was for these reasons that the constitution of the partnership was held to be not illegal.

(32) A question of partnership was examined by the Andhra Pradesh High Court in *'Additional Commissioner of Income-tax, A.P. vs. Degaon Gangareddy G. Ramkishan & Co. and others;* (3). That was, however, a case of the constitution of a sub-partnership. One of the partners of the firm holding the licence had constituted a sub-partnership in order to raise the necessary money for the purpose of investing as capital. It was held that the members of the sub-partnership did not become partners of the main firm as a sub-partnership firm was a different and distinct entity. The business of the sub-partnership firm was described in its partnership deed as financing of the capital of the main partner. It is, therefore, a case where the controversy was different and does not directly relate to the question before us.

(33) The genuineness of a firm was, examined by the same High Court in *'Commissioner of Income-tax, A.P. vs Nalli Venkataramana and others;* (4). After examining the Andhra Pradesh Excise Rules, it was held by the High Court that there was no contravention of the rules when the licensee entered into a partnership with others for sharing the profits and losses arising out of the use of the licence. This decision has, however, been subsequently disapproved by the Supreme Court which was shall examined hereinafter while referring to the decision of the Supreme Court.

(34) This High Court once examined a partnership agreement executed by a licensee in *'L. Shiv Dayal L Mela Mal and others vs Firm Bishan Dass Shankar Dass;* (5). That was a case where licence

3. 111 I.T.R. 93
4. 145 I.T.R. 759
5. A.I.R. 1961 Pb. 405

under the opium Act had been obtained and a third person was allowed to enter the partnership. The objection arose to the effect that the third person was a non-licensee under the opium Act. It was noticed by the Court that the third person had entered into an agreement to share the profits and losses of the business in consideration of his contribution towards the capital of the business and, therefore, such an agreement was neither illegal nor in contravention of any rules framed by the Punjab Government under the opium Act. It was further observed that such an agreement did not involve the transfer or sub-lease of the licence because the licensee alone remained personally responsible to the government. No privilege under the licence was transferred to the third person. Order 59 of the Punjab Opium Orders, 1956 prohibited the transfer or sub-letting of a licence by the holder thereof without the permission of the Deputy Excise and Taxation Commissioner. It was in the light of the aforesaid rule that admission of a new partner to the business was held to be not in the nature of a transfer or sub-letting of the liquor licence.

(35) A similar question happened to be again examined by this Court in *Commissioner of Income-tax, Patiala vs. Gian Chand & Co.*; (6). That was a case where a firm with five partners had obtained licence in their separate names from the Fisheries Department of the Punjab Government for fishing in the public water. Four more persons were taken in the firm as partners. Thus, the firm came to be constituted with nine partners. The I.T.O. refused the registration on the ground that the firm was not genuine. It was noticed by the Court that there was no rule prohibiting the entry into a partnership so far as the Fishing Licenses were concerned. There was no express provision so far as the sale of fish was concerned. In that situation, it was held that the partnership was not illegal.

(36) The question of genuineness of a firm has also been examined by this Court in *Commissioner of Income-tax, Patiala vs. Suraj Bhan & Co.*; (6A). That was a case where the firm indulged in certain speculation business, which activity was unlawful. Registration under Section 185(1)(b) of the Act was refused merely on the ground that the business carried on by the firm was unlawful. It was held that merely because the partners indulged in speculation business, that would not make the firm non-genuine. This decision is also not relevant to the present controversy before

us inasmuch as certain activities of the partners were found unlawful in that case.

(37) A similar question was again examined by this Court in '*Commissioner of Income-tax vs. Sham Lal Kewal Krishan*'; (7). The firm was running a liquor contract under licenses obtained from the Government. During the course of proceedings under Section 132(5) of the Act, the assessee produced a second set of accounts called set No. 2 wherein were recorded certain transactions not finding any place in the books of accounts seized from the assessee. Those accounts disclosed that the assessee had violated the provisions of the Punjab Excise Act and the rules made thereunder. The assessee, though assessed in the status of a firm, was denied the benefit of registration. It was noticed by the court that the purpose of the partnership was to carry on licensed activities and, therefore, it did not render the constitution of the firm illegal. This decision of the Court relied upon by the assessee would not help him inasmuch as the facts therein are distinguishable.

(38) In '*Jer and Co. vs. Commissioner of Income-tax*', (8). The Supreme Court examined the case of a firm constituted by two brothers to carry on the business as wholesale merchants in foreign liquor. One brother obtained a licence from the excise authorities for the wholesale vending of foreign liquor. The licence contained no prohibition against entry into partnership for carrying on the business in foreign liquor by the holder of the licence. It was noticed by the Supreme Court that the licence was in Form F1-II issued under the U.P. Excise Manual. The licence did not prohibit the holder from entering into partnership. It merely provided that the licence shall not be sublet or transferred. Since there was no prohibition against entry by the holder of the licence into a partnership, the question whether the partnership was illegal did not arise. It was further held that Rule 322 of the Excise Manual which prohibited the holder of a licence from entering into a partnership with another person had no application to the case. It was in this context that the constitution of the firm was held as legal and entitled to registration.

(39) In '*Additional Commissioner of Income-tax vs. Degaon Ganga G. Ramkrishna and Co.*'; (9). The Supreme Court has recently examined a case of sub-partnership. A partnership had been formed

7. 159 I.T.R. 330
8. 79 I.T.R. 546
9. 214 I.T.R. 650

with 17 partners, one of whom held 10% share. The licensee being the highest bidder at an auction held by the excise authority, the partnership was registered under the Income-tax Act. The aforesaid partner holding 10% share found it difficult to contribute the required capital towards his share and he, therefore, formed a sub-partnership with 11 other persons who agreed to provide the finance on being taken as partners. The partner of the sub-partnership filed an application for its registration as a firm but the I.T.O. rejected the claim on the ground that no business was conducted by it during the relevant year and that the sub-partnership was void *ab initio* under the Andhra Pradesh (Telan Ganga Area) Abkari Act. It was held by the Court that the members of the sub-partnership did not become partners of the main firm and the two being different and distinct entitled for the purposes of the act, the sub-partnership was entitled to be registered under the Act. This decision is also not directly related to the controversy before us inasmuch as the question of sub-partnership was decided on entirely different facts.

(40) The following observations (at page 654) are, however, significant:—

“After correctly stating the legal position, the High Court referred to the contents of the deed of sub-partnership and the finding of the Tribunal that the assessee-sub-partnership cannot be said to have not carried on any business; that the sub-partnership had financed and owned the capital invested by one of its partners in the main firm; and that the sub-partnership had been formed mainly to finance the business of one of the partners of the main firm doing abkari business and share the profits and losses accruing to or received by him from the main firm. The High Court also observed that the sub-partnership confined its business to only sharing the profits earned by one of the partners of the main partnership doing abkari business in lieu of their capital invested for the share of that partner and, therefore, it cannot be said that such a sub-partnership is prohibited in law. The decisions relied on by the Revenue were distinguished by the High Court on the facts since they related to partnerships formed for carrying on business in prohibited articles without the grant of a licence in favour of that partnership.”

(41) A similar question of sub-partnership was examined by

a larger Bench of the Supreme Court in *The Commissioner of Income-tax, Andhra Pradesh vs. M/s B. Posetty & Co.* (10) and the view taken earlier by a Bench of two Judges of that Court in *Degaon Ganga Reddy G. Ramakrishna and Co.'s case* (supra) was affirmed. The following observations (at page 107) are relevant:—

“In this case, the lessee is Nizamabad Group Sendhi Contractors (main firm). The sub-partnership is a distinct and different firm. It is one recognised by law and it is not a partnership with the main firm. It will not have the effect of making the partners in the sub-partnership partners of the main firm. In other words, the main firm, the lessees and the sub-partnership are distinct and different. In the light of the above legal position, it cannot be said that either the sub-partnership in the instant case, or any of its partners as a partners, became a partner of the main firm, Nizamabad Group Sendhi contractors. The inhabition contained in Section 14 of the Abkari Act will apply only in a case where the lease declares any person as its partners here, the lessees, M/s Nizamabad Group Sendhi Contractors, had not declared either the sub-partnership or any other person, as its partner. In such circumstances, the inhabition contained in section 14 of the Abkari Act cannot apply. It is true that Sri Posetty and 10 others formed the sub-partnership, “B. Posetty & Co.”—for a legitimate business purpose, to provide the requisite finance, on condition of allotment of certain shares to them out of Mr. Posetty's share in the main firm. The sub-partnership financed one of its partners to make a capital investment in the main firm. Such an arrangement or agreement between persons who formed a distinct and different firm, is valid in law and to such a situation section 14 of the Abkari Act is not attracted; nor is there any basis to hold that there was any contravention of the provisions of the said Act. Law recognises formation of sub-partnership. The main partnership and the sub-partnership are, for the purpose of law, distinct and different entitles. Registration cannot be refused to the sub-partnership on the ground that one of the partners of the main firm had agreed to

share the profits received by him from the firm, with a stranger or strangers (members of the sub-partnership) since the agreement does not make the stranger of strangers or the sub-partnership firm, a partner in the original firm and such an arrangement or agreement does not affect either the main firm or its other members, in any way. Section 14 of the Abkari Act has not application to such a situation. The Full Bench of the Kerala High Court in *Narayanan and Co. vs. Commissioner of Income Tax 223 I.T.R. 209* has held that when a licensee entered into a partnership with others, even if there was no sale of his rights to the partners during the subsistence of the partnership, the licensee will not be in a position to deal with the licence as his own. His right became restricted to the share of profit which may fall to his share from time to time. In other words, he transferred a portion of his exclusive privilege to deal in liquor covered by the licence in favour of his partners. It was held that the contract of partnership was void inasmuch as the transfer was hit by the provisions in Rule 6(22) of the Kerala Abkari Shops (Disposal in Auction) Rules, 1974. Thus, the Full Bench of that High Court has laid down that where there was a specific prohibition, any partnership entered into in contravention of those provisions, would be unlawful and void. Such an agreement cannot be recognised under the Act as a genuine partnership.

(42) This Court examined the formation of a firm for carrying on the business in opium in *Commissioner of Income tax vs. Banarsi Das and Company* (11). A licence for the sale of opium was granted to one Banarsi Das of Faridkot. The said Banarsi Das entered into a partnership with seven other persons. It was expressly stated that the firm had been formed to run the opium contracts. An application was made for registration of the partnership firm. The I.T.O. declined to grant registration on the ground that the object of the firm was unlawful. It was noticed by the Court that Rule 40 of the Opium Rules provided for the grant of a licence for the sale of Opium by retail. According to Rule 54, when the licence was granted to a partnership or a firm not incorporated under any Act, all the individuals comprising the partnership or firm were to be

specified on the licence. Rule 55 provided that on the application in writing of all the original partners, a partner may at any time be added by authority competent to grant the licence provided that he was otherwise eligible. It was found by the Court that condition (t) of Rule 40 prohibited the licensee from allowing any person to conduct sales in his behalf unless the name of such person had been previously submitted to the Deputy Excise and Taxation Commissioner or the Excise and Taxation Officer for approval and his name was endorsed on the licence. It was observed that the policy underlying the Act and the rules was that only an approved persons specifically licensed should be allowed to sell opium. It was held that in view of the rules regulating the grant of licence for the sale of opium, the object of the firm was unlawful and the firm could not be registered under the Act.

(43) In *Lal Chand Mohan Lal Fazilka vs. Commissioner of Income-tax, Punjab*; (12) a Division Bench of this Court had again an occasion to examine the case of registration claimed by a firm doing opium business. It was held that a firm carrying on the opium business under an opium contract taken in the names of some of the partners only was not a validly constituted firm under the provisions of the Opium Act and was not entitled to registration. In that case, the opium contracts were in the names of M/s Lal Chand Mohan Lal. The Tribunal examined Kishori Lal, one of the partners, and was satisfied that the persons who were not licensees were actually carrying on the business. It was noticed by the Tribunal that persons other than licensees had acted on behalf of the licensees in contravention of the provisions of the Punjab Excise Act, 1914. There was nothing in the deed of partnership to show that any of the partners was merely a financing or a sleeping partner and was not to actively participate in the business of sale of opium and poppy heads. It was held that the statutory provisions contemplated a partnership carrying on the business of sales of opium only if a licence was taken in the name of the firm. It is, thus, clear that wherever prohibition is found in the statutory provisions against the business by non-licensees, the activity of the firm constituted with non-licensees is held to be not legal.

(44) In *Commissioner of Income-tax, Patiala-I vs. Hardit Singh Pal Chand & Co.*; (13), this Court again took the view that where there was a clear finding that the names of certain persons

12. 65 I.T.R. 418

13. 120 I.T.R. 289

who were strangers to the licence had not been endorsed on the licence in terms of the rules, the firm constituted with those persons was not entitled to be registered for the purposes of income tax under Section 184 and 185 of the Act because it carried on the business of possessing and selling liquor in violation of the provisions of the Punjab Excise Act and the rules framed thereunder as also of the conditions of the licence.

(45) It was noticed by the court that by virtue of the conditions in the licence to the effect that the licensee is granted subject to the provisions of the rules those provisions stand incorporated as conditions in the licence.

(46) A question about the registration of firm engaged in the liquor business again came for examination before this Court in '*Commissioner of Income-tax vs. Rajwant Singh and Co.*'; (14). An application under Section 256(2) of the Act was move dby the department seeking a direction to the Tribunal to submit a statement of the case and to refer a question of law. A Division Bench of this Court examined the question and noticed that registration to the firm was refused by the I.T.O. on the ground that the Excise and Taxation Department had issued the licence in favour of the firm consisting of 11 partners whereas the firm had been constituted with 14 partners for the purposes of registration under the Act. it was seen that the Tribunal had remanded the case for holding an enquiry as to whether such persons other than 11 persons in whose favour the original licence was granted by the Excise and Taxation authorities had actually possessed and handled liquor in order to determine whether the partnership firm of 14 partners violated any rules and regulations under the Excise Act. The Court held that no referable question of law arose inasmuch as the question depended upon the proof of fact as to whether the persons whose name did not find mention in the licence had actually and physically handled and sold liquor or not.

(47) The Supreme Court has, in '*Bihari Lal Jaiswal and others vs. Commissioners of Income-tax and others*'; (15), categorically laid down that where the licence was issued for business in liquor in the name of an individual and the conditions in the licence expressly prohibited the formation of partnership by the licensee. The partnership firm in violation of such condition was not entitled to

14. 209 I.T.R. 539

15. 217 I.T.R. 746

registration under the Act. In that case, a licence for retail sale of country spirit had been obtained by one Bihari Lal Jaiswal under the Madhya Pradesh Excise Rules, 1960. Bihari Lal Jaiswal entered into a partnership with 10 other persons to conduct the business under the said licence. The L.T.O. rejected the application for registration on the ground that the partnership having been formed in violation of Clause (vi) of the General Licence Conditions prescribed by the Madhya Pradesh Excise Rules was illegal and could not claim registration under the Act. Under the said Clause, no privilege of supply or sale could be sold, transferred, or sub-leased nor could a holder of any such privilege enter into a partnership for the working of such privilege in any way or manner without the written permission of the Collector. It was found that the written permission of the Collector was not obtained for entering into such partnership, though the assessee said that they had applied for the same. The Supreme Court took the view that a partnership prohibited by the excise law cannot be granted registration under the Act. The decision of the Andhra Pradesh High Court in '*Commissioner of Income-tax, A.P. vs. Nalli Venkataramana & others*' (Supra) was also considered by the Supreme Court and the correctness of the interpretation placed by the High Court on Rule 19(2) of the Andhra Pradesh Excise Rules, 1969 was not approved. It was observed that the correctness of the said rule did not fall for the consideration but even so the proposition as laid down by the High Court was unacceptable. As has already been seen by us that the Andhra Pradesh High Court in '*Commissioner of Income-tax, A.P. vs. Nalli Venkataramana and others*' (Supra) had taken the view that Rule 19(2) of the relevant rules was not applicable to a case where the licence was granted in the name of a single person and he formed a partnership to run the business in liquor with two or more persons.

(48) The decision of the Supreme Court in '*Bihari Lal Jaiswal vs. Commissioner of Income Tax and others*' (supra) has finally laid down as under:—

“In our opinion, the correct position appears to be this (we are confining ourselves to the partnerships entered into with respect to a licence/permit granted under the State excise enactments): these enactments deal with intoxicating liquor, that is to say, the production, manufacture, possession, transport, purchase and sale of intoxicating liquors (entry 8 of list II of the Seventh Schedule to the Constitution) and other noxious

substances besides providing for duties of excise referred to in entry 51 of the said List. It has been held by this Court repeatedly that no person has a fundamental right to deal or trade in intoxicating liquors and that the State is entitled to prohibit and/or closely regulate their production manufacture, possession, transport, purchase and sale. It is enough to refer to the recent Constitution Bench judgment in *Khoday Distilleries Ltd. vs State of Karnataka* (1995) 1 SCC 574, wherein all the earlier decisions of this Court have been referred to and the proposition aforesaid affirmed. The right of a citizen to deal in these intoxicating liquors is only to the extent it is provided for and permitted by the Act and the Rules made thereunder. Take the Madhya Pradesh Act, with which we are concerned herein. Clause (VI) of the General Licence Conditions—It is not disputed that these conditions are statutory in character—provides expressly that a holder of licence/privilege shall not enter into a partnership for the working of such privilege in any way or manner without the written permission of the Collector, which permission shall be endorsed on the licence. This condition is binding upon the licensee. If so, he can not enter into a partnership nor can there be, in law, a partnership with respect to the privilege (business) granted under the licence. No person, and no licensee can claim any right contrary to the said provision. The object underlying the said clause is self evident. Since the licence is granted for dealing in intoxicating liquors, the business wherein is *res extra commercium* and also because they are supposed to be harmful and injurious to the health and morals of the members of the society—close control is envisaged and provided over the business carried on under the licensee is permitted to bring in strangers into the business, which would mean that instead of the licensee carrying on the business, it would be carried on by others—situation not conducive to effective implementation of the excise law and consequently deleterious to public interest, it is for this very reason that transfer or subletting of licences is uniformly prohibited by several State excise enactments. It, therefore, follows that any agreement whereunder

the licence is transferred, sublet or a partnership is entered into with respect to the privilege/business under the said licence, contrary to the prohibition contained in the relevant excise enactment, is an agreement prohibited by law. The object of such an agreement must be held to be of such a nature that if permitted it would defeat the provisions of the excise law within the meaning of section 23 of the Contract Act. Such an agreement is declared by section 23 to be unlawful and void. The question is whether such an unlawful or void partnership can be treated as a genuine partnership within the meaning of section 185(1) and whether registration can be granted to such a partnership under the provisions of the Income tax Act and the Rules made thereunder. We think. When the law prohibits the entering into a particular partnership agreement, there can be in law no partnership agreement of that nature. The question of such an agreement being genuine cannot, therefore, arise. Where, of course the statutory provisions or the conditions of licence do not prohibit the entering into of partnership, it is obvious, such a partnership cannot be held to be illegal, unlawful or void, as held by this Court in *Jer and Co.'s case* (1971) 78 ITR 546. But where there is a specific prohibition as in the case before us, any partnership entered into would be an unlawful and void agreement within the meaning of section 23 and no other law, whether State or Central, can recognise such an agreement. The fact that such a partnership can be permitted by the Collector does not detract from the mandatory character of the clause. As pointed out above, Licence Conditions No. 14 expressly provides that for breach of any condition of licence or of the Act or the Rules made thereunder, the licence may be cancelled. The context-that it is an excise enactment-should not be forgotten. The grant of registration under the Income Tax Act, it must be remembered, confers a substantial benefit upon the partnership firm and its members. There is no reason why such a benefit should be extended to persons who have entered into a partnership agreement prohibited by law. One arm of law cannot be utilised to defeat the other arm of law. Doing so would be opposed to public policy and bring the law into ridicule. It would be wrong

to think that while acting under the Income-tax Act, the Income tax Officer need not look to the law governing the partnership which is seeking registration. It would probably have been a different matter if the Income-tax Act had specifically provided that the registration can be granted notwithstanding that the partnership is violative of any other law but it does not say so."

(49) In view of the observations made by the Supreme Court, as reproduced above, it is finally settled that a partnership firm cannot be constituted by a licensee with the help of strangers unless he obtained the requisite prior approval from the competent excise authority. It may further be noticed that sub-rule (26) of Rule 37 requires the endorsement of the names of all persons engaged in the business on the licence. In this situation, the constitution of the firm in the case before us is found to be in contravention of Rule 7 and Rule 37(26) of the Punjab Liquor Licence Rules, 1956.

(50) Shri A.K. Mittal has also challenged the order passed by the Commissioner of Income-tax in exercise of his power under Section 263 of the Act, it has been argued that the order of the I.T.O. has not been declared to be prejudicial to the interest of the revenue and, therefore, order under Section 263 was not a valid and good order. Reliance has been placed by Shri Mittal on two decisions of this Court (i) '*Commissioner of Income-tax, Patiala-II vs. Chawla Trunk House*; (16) and (ii) '*Jagadhri Electric Supply and Industrial Co. vs. Commissioner of Income-tax*; (17).

(51) We do not find any merit in the plea inasmuch as the Commissioner has in his order under Section 263 clearly observed in para 1 as under:—

"Since these facts indicated that the I.T.O. had granted registration to the firm without proper application of mind and against the provisions of law, a notice under Section 263 was issued to the assessee on the basis that the order under Section 185 (1)(a) was erroneous in so far as it was prejudicial to the interest of the revenue."

(52) Since the Commissioner has already held that the order was erroneous in so far as it was prejudicial to the interest of the revenue, the challenge has no substance and is rejected.

16. 139 I.T.R. 182

17. 166 I.T.R. 143

(53) In the result, it is held that the order of the I.T.O. refusing registration to the firm on the ground that the firm was not a genuine one because a non-licensee was allowed to become a partner in the firm, is not assailable. The question is, therefore, answered in the negative i.e. in favour of the department and against the assessee.

S.C.K.

Before G.S. Singhvi & K.S. Kumaran, JJ

The State of Punjab,—Appellant

versus

Amar Singh,—Respondent

LPA No. 761 OF 1991

27th January, 1998

Constitution of India, 1950—Arts. 14 & 16—Reversion of ad hoc promotee—petitioner promoted as ad hoc General Manager in Punjab Roadways—After one year 5 months, petitioner reverted as Works Manager on the ground of pending enquiry and special confidential report—Learned Single Judge finding no action can be taken on seven year old charge-sheet and that confidential reports were available to Govt. when he was promoted on ad hoc basis—Reversion in face of retention of junior ad hoc General Managers is unjustified—Ambit and reach of Arts. 14 & 16 in the context of termination of temporary employee or reversion of ad hoc and officiating promotee—Legal position—Explained & enunciated.

Held that :

- (i) Article 14 is the genus while Article 16 is the species. It gives effect to the doctrine of equality in all matters relating to public employment;
- (ii) The wide sweep of Articles 14, 15 and 16 takes within its fold not only the legislative instruments and all executive/administrative actions of the State and its agencies/instrumentalities but also contractual matters;
- (iii) Every State action must be informed by reasons. It must be fair, reasonable and in public interest and must be free from arbitrariness.
- (iv) The basic requirement of Article 14 is fairness in State