IN THE HIGH COURT OF JUDICATURE AT MADRAS

Dated: 18/05/2004

Coram

The Honourable Mr.Justice A.S.VENKATACHALAMOORTHY
and
The Honourable Mr.Justice P.K.MISRA

W.P.No.36510 of 2002
and
W.P.M.P.No.54912 of 2002

1. M.V.Ganesh

2. Mrs.Rajee Viswambaran ... Petitioners

-Vs-

1. The Commercial Tax Officer,
Thirunelveli P.O.,
Thirunelveli District,
Tamilnadu.

2. The Deputy Tahsildar,
Revenue Recovery,
Revenue Recovery Office,
Thiruvananthapuram.

3. The District Collector,
Collector's Office,
Thiruvananthapuram.

4. Tamilnadu Taxation Special Tribunal,
Singaravelar Maligai,
Second Floor,
Rajaji Salai,
Chennai - 1. ... Respondents

This writ petition has been filed under Article 226 of Constitution of India, praying this Court to issue a writ of Certiorari, as stated therein.

For Petitioners : Mr.V.Ramachandran,
Senior Counsel
for M/s Anitha Sumanth

For Respondents : Mr.T.Ayyasamy,
Special Govt.Pleader (Tax)

:O R D E R

A.S.VENKATACHALAMOORTHY, J.

The petitioners, who received notice in Form No.I under the Revenue Recovery Act, stating that a sum of Rs.9,92,025/- is due towards tax and penalty in respect of the assessment year 1986-87, approached the Tamil Nadu Taxation Special Tribunal by filing O.P.No.560 of 2000 and disputing their liability contending that after receiving the said notice, they approached the High Court of Kerala, filed writ petition on the ground that there was no tax due and payable by them to the Commercial Tax Department and that the Recovery proceedings are void. The case of the petitioners is, after filing the writ petition, they understood that arrack blending licence was obtained in the name of one S.Sewak from the Commissioner (Prohibition and Excise), Madras and in which the late M.S.Viswambaran, the father of the first petitioner and husband of the second petitioner was also a partner and some arrears of sales tax was stated to be due. As per the provisions of the Act and conditions of licence, the licensee S.Sewak is not supposed to form a partnership to carry on the said business of arrack blending and such a partnership is an illegal one. That apart, it was also contended that none of the petitioners are partners in the said business and after the death of those two persons viz., S.Sewak and Viswambaran, the tax liability was shifted on the legal heirs of Viswambaran, which is untenable because there is no valid partnership business.

2. On behalf of the department it was contended that the arrack blending unit had been functioning under the name and style of " Methanath Agencies" and the Sales Tax authorities are collecting tax regularly. But however, after the introduction of partial prohibition, that is from 1.1.1987, there was some difficulty in payment of the tax and the cheques tendered for a sum of Rs.18 lakhs bounced. The revenue contended that the licence was granted to run the arrack blending unit only to S.Sewak, who secretly constituted a partnership in and by the said partnership, Sewak had been allotted only 5% shares and for the late Viswambaran and the petitioners 95%. Their interest and share in the business had been confirmed by means of an order of the High Court of Madras. The department took action to recover the arrears by initiating Revenue Recovery Proceedings. The Commercial Tax Officer had acted only in accordance with the provisions of the TNGST Act and Revenue Recovery Act and consequently the original petition has to be dismissed.

3. The Tribunal after elaborately considering the case, dismissed the OP holding that it is a clear case of tax evasion. The aggrieved petitioners are now before this Court by filing this writ petition.

4. Before this Court, the learned counsel for the petitioners reiterated the submissions already made before the Tribunal. Briefly the learned counsel contended that the partnership was formed for the purpose of exploiting the arrack blending licence issued in the name of S.Sewak and the same was in violation of the terms and conditions of the licence. Hence the partnership so constituted was nothing but an illegal partnership. The business carried on by such partnership cannot be taxed under the Sales Tax Act. Secondly it is contended that the petitioner was a minor at the relevant time when the partnership was formed so also during the relevant assessment

year and hence the first petitioner, who was admitted only to the benefits of the partnership firm, cannot be made liable to pay the tax due, if any.

5. We heard the elaborate arguments advanced by the learned counsel for the respective parties and also perused the records available before us. An arrack blending unit licence was obtained by one S. Sewak and thereafter, a partnership agreement was entered into on 9.8.198 1, but with effect from 16.5.1981. The partnership was titled as " Methanath Agencies" formed for the exploitation of the licence issued to S.Sewak by the Commissioner (Prohibition and Excise), for manufacture and supply of arrack. The profits of the business were divided as follows,

S.Sewak .. 5%
M.S.Viswambaran .. 35%
Rajee Viswambaran .. 35%
M.V.Ganesh .. 25%

The partnership further stipulated that the second and third partners (M.S.Viswambaran and Rajee Viswambaran) agreed that they shall bring the necessary finance for setting up and running of the factory and that in the event of there being any loss, the same shall be borne by them in equal shares.

6. The assessment order for the year 1986-1987 was passed on 25.3.1988 in the name of Tvl.Methanath Agencies. Sales tax due for the assessment years upto 1985-86 (from 1981-82) were paid by the firm. When recovery proceedings were initiated for non payment of tax due for the assessment year 1986-87, late M.S.Viswambaran filed W.P.No.1069 7 of 1987 on the file of this Court on the ground that he was not a partner or proprietor of the firm and that he has been extending only financial assistance to the concern. The High Court disposed of the said writ petition directing the party to present a petition to the Commercial Tax Officer, who was directed to enquire into the same and pass appropriate orders. The Commercial Tax Officer conducted detailed enquiry and came to the conclusion that even though licence was granted in the name of S.Sewak, the business was conducted in the name of Methanath Agencies and that in fact M.S.Viswambaran was a partner of the said firm. Again when the recovery notices were issued, M. S.Viswambaran filed W.P.84 of 1989, practically seeking the same relief. The said writ petition was dismissed and the High Court directed Viswambaran to seek relief before the Deputy Commissioner. The revision petition earlier filed by him before the Deputy Commissioner was dismissed on 15.2.1989 confirming the order of the Commercial Tax Officer. For the third time the said Viswambaran filed W.P.No.1300 of 1988 praying the Court to issue a writ of mandamus forbearing respondent from recovering the tax arrears from him in pursuance of notice dated 22.3.1988. The said writ petition was subsequently transferred to the Tamil Nadu Taxation Special Tribunal and renumbered as T.P. No.2962 of 1999, which on 9.12.1998 dismissed the same holding that the said Viswambaran was guilty of abuse of process of the Court. Now when the department is taking steps to recover the dues invoking the Revenue Recovery Act, the petitioners have approached this Court by filing the above writ petition.

7. The Commissioner of Prohibition and Excise granted arrack blending licence to one late S.Sewak. There is no dispute that the said licence cannot be transferred by the licensee. Equally, there is no dispute that the activity of arrack blending cannot be done by any one else other than

the licensee. If such an activity is carried on by one other than the licensee, it will be an offence since the same would be violative of the provisions of the Tamil Nadu Prohibition Act. As noted already, the partnership was formed for the sole purpose of exploiting the licence issued to late S.Sewak by the Commissioner of Prohibition and Excise, Madras. That being so, the partnership which was entered into in the year 1981 referred supra was an illegal partnership.

8. The next question is whether an illegal partnership can be taxed under the Tamil Nadu General Sales tax Act. We find the answer to this question from the various rulings referred to hereunder.

(a) In 16 ITR 412 (Mohamed Abdul Kareem and Co. v. Commissioner of Income-tax), number of persons took arrack shops separately on lease, but constituted themselves into a partnership and agreed that all the shops leased in the names of the partners should be run by the partnership. An application was made for registration of the firm under Section 26A of the Indian Income-tax Act, 1922, which was rejected for the reason that the formation of a partnership with regard to arrack and toddy shops was prohibited by abkari law without the previous permission of the District Collector. The firm was assessed as an 'association of persons' but the assessee contended that as there was no lawful partnership, assessment could be made only upon each individual lessee. The Division Bench of Madras High Court ruled that the assessee was an 'association of persons' within the meaning of Section 3 and so long as its object was to carry on for gain a business which was not unlawful (the object being to sell arrack or toddy, as the case may be under the authority of a licence duly granted by the Government) the supervening circumstance of the formation of a partnership in contravention of the abkari law did not render the income, profits and gains of the association immune from taxation. We hereunder extract certain paragraphs found in that judgment, which in our opinion are very relevant and interesting.

"The whole position has been put in the most telling manner by Rowlatt, J., in Mann v. Nash, ((1932) 16 Tax Cases 523). There the assessee was carrying on the business of providing automatic machines, the use of which had been held to be illegal. It was claimed that the portion of profits derived from that business was immune from taxation on the ground that it had been earned by unlawful means. It was held that the profits were chargeable with income-tax. Three arguments were addressed and each of them was met by Rowlatt, J., in his own inimitable manner:-

"The great mainstay of Mr.Field's argument, quite rightly from his point of view, was the case of Duggan ((1929) I.R. 406, decided in the Irish Free State, and that decision of the Supreme Court seems to have gone upon this principle that no construction could be admitted which recognised that the State should come forward and seem to take a profit from what the State prohibited, because the State ought to have prevented it; and it was argued, if I may venture to say so, in a somewhat rhetorical style: Does the State keep its revenue eye open and its eye of justice closed ? I must say, I do not feel the force of that observation at all. Would it have m ade any difference, I ventured to ask in the argument, if the State had kept both its eyes open and prosecuted the man for the lottery and taxed him for the profits at the same time ? That would at any rate have protected the State from the reflections which were made upon it in the words I have quoted. But, in

truth, it seems to me that all that consideration is misconceived. The Revenue representing the State, is merely looking at an accomplished fact. It is not condoning it; it has not taken part in it; it merely finds profits made from what appears to be a trade, and the Revenue laws happen to say that the profits made from trades have to be taxed, and they say: "Give us the tax." It is not to the purpose in my judgment to say: 'But the same State that you represent has said they are unlawful'; that is immaterial altogether and I do not see that there is any contact between the two propositions.

It was said in the Irish case that allegans suam turpitudinem non est audiendus. I cannot see that the State are alleging their own turpitude; it is the appellant who is alleging his own turpitude. The State says: 'It is a business'; the appellant says: 'It is an unlawful one'; he is alleging his own turpitude.

It is said again: 'Is the State coming forward to take a share of unlawful gains?' It is mere rhetoric. The State is doing nothing of the kind; they are taxing the individual with reference to certain facts. They are not partners; they are not principals in the illegality, or sharers in the illegality; they are merely taxing a man in respect of those resources. I think it is only rhetoric to say that they are sharing in his profits, and a piece of rhetoric which is perfectly useless for the solution of the question which I have to decide."

The Court after referring to the facts of the case in Lindsay, Woodward and Hiscox v. Commissioners of Inland Revenue ((1933) 18 Tax Cases 43, quoted a paragraph in the said judgment which reads as under,

"The Lord President (Clyde), made certain observations which are apposite to the present case. Considering the question whether the transactions were in the nature of trade, his Lordship observed:-

"This point cannot be dissociated from another, namely, whether the trading transactions, if such they were, were so tainted with illegality and wrongdoing that the profits made by means of them fall outside 'the profits of trade' which are assessable to income-tax under the Act of 1918 ..... There are many transactions which are illegal in the sense that the obligations upon which they depend are not such as the law will enforce. I think it is plain that a contract of partnership, the object of which is to trade in a way which necessarily involves resort to fraud on the customs authorities of this country, is not a contract which this country's law will enforce. I do not, however, think that, merely because the contract was not enforceable by law, profits actually made by the partnership's trading operations must necessarily be placed beyond assessment to income-tax as profits of 'trade' ...."

Lord Sands said at page 56:-

"Crime, such as housebreaking, is not trade, and therefore the proceeds are not caught by the tax. It does not follow, however, that there cannot be a business answering to the description of trade, albeit it is tainted with illegality. Trafficking in drugs, for example, is of the nature of trade, albeit such trafficking may in the circumstances be illegal. I respectfully adopt the dictum of Lord Haldane, in delivering the judgment of the Privy Council in the case of Canadian Minister of Finance v. Smith ((1927) A.C. 193), that once the character of a business has been ascertained as being of the nature of trade, the person who carries it on cannot found upon elements of illegality to avoid the tax."

Lastly the dictum of Lord Morison is equally forcible:-

"It is, in my opinion, absurd to suppose that honest gains are charged to tax and dishonest gains escape. To hold otherwise would involve a plain breach of the rules of the statute, which require the full amount of the profits to be taxed and merely put a premium on dishonest trading. The burglar and the swindler, who carry on a trade or business for profit, are as liable to tax as an honest business man, and, in addition, they get their deserts elsewhere.""

(b) 31 ITR 457 (V.K.Kumaraswami Chettiar v. Additional Income-Tax Officer, Madras and another) is a case where four persons including the petitioner carried on abkari business and they commenced the business on 7th October, 1944. But the said association was dissolved after the close of the accounting year. When notice under Section 34 of the Income-Tax Act was issued to the petitioner in 1950, he returned it stating that the business was being managed by one Rowther and hence the notice should go only to him. Thereafter the notice was sent to the said Rowther, who paid only a portion of the tax levied and the balance was demanded from the petitioner. The petitioner filed writ petition praying the Court to quash the order of the Income-tax Officer making demands for payment of tax raising several contentions and one among them being that there could be no legal and valid partnership in respect of abkari business, the assessment itself was illegal. The argument was, the Income-tax Officer has no jurisdiction to treat an illegal partnership as if it were a legal association. A Division Bench of this Court, following the earlier ruling referred supra, i.e, 16 ITR 412, rejected such a contention.

(c) In the case reported in 217 ITR 746 (Bihari Lal Jaiswal and Others v. Commissioner of Income-tax and others) a licence for retail sale of country spirit was issued under the Madhya Pradesh Excise Rules, 1960 to one Biharilal Jaiswal in respect of twenty-two outstall shops in a particular district in the public auction held in January, 1968. The licence was effective for the period commencing on April 1, 1968, and ending with March 31, 1969. The said licensee Biharilal Jaiswal entered into a partnership with ten other persons to conduct the business. Application for grant of registration to the said firm under Sections 184 and 185 of the Income Tax Act, 1961 was made. The question arose in that case was as to whether the request for such registration could be granted. The Supreme Court of India answered in the negative holding that 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 and that it would probably have been a different matter if the Incometax Act had specifically provided that the registration can be granted notwithstanding that the partnership is violative of any other law. In the said judgment, the Supreme Court observed as under,

"We may clarify that our holding does not mean that such an illegal partnership cannot be taxed. It is certainly bound to be taxed either as an unregistered partnership firm or as an association of persons. The only question considered herein is its right to claim registration under the Income-tax Act."

Hence this Court does not find any substance in the first contention of the petitioners that an illegal partnership cannot be taxed under the Tamil Nadu General Sales Tax Act.

9. So far as the second contention is concerned, we are forced to open our discussion by branding the petitioner as a classic liar. The assessment year in question is 1986-87 (accounting year 1.4.1986 to 31.3.1987) and the assessment order came to be passed on 25.3.1988. Before the Tribunal, the first petitioner pleaded that even during 1 986-87, he was a minor. In the affidavit filed in support of the petition, a claim to the same effect is made in ground (G). But whereas, if we see the reply affidavit filed before the Court in the month of March, 2004, the petitioner's age has been mentioned as 37 years, which should mean he became major in the year 1985. We asked the learned Senior Counsel appearing for the petitioners to ascertain from the first petitioner, who was very much present in the Court, as to when he became major. The Court was informed that the first petitioner became major in the year 1985. From the above it is clear that the first petitioner has uttered falsehood, obviously in an endeavour to escape from his tax liability.

10. The learned counsel appearing for the petitioners contended that a minor cannot become a member of the association of persons and that being so, in any event, at least as against him the department cannot proceed with the recovery of taxes due. The learned counsel appearing for the department would place reliance on the decision reported in AIR 1968 SC 317 (M.M.Ipoh and others v. The Commissioner of Income-tax, Madras) and submit that there is nothing in the Act which would indicate that a minor cannot become a member of the association of persons for the purpose of the Act and hence there is no substance whatsoever in this submission made on behalf of the first petitioner. In that case, one M(I) was the husband of A and they had two sons C and M(2), both minors in the year 1940. The Hindu undivided family traded in the name of "M.S.M.M.". The family carried on extensive business in money-lending, rubber plantations, and in real estates in Malaya, Burma and India. In February, 1940, the property of the family was divided between three male members and M(1) was allotted the business of the family at Rangoon and at Karaikudi and three rubber estates in Malaya. But even after the partition, M(1) continued to remain in management on behalf of himself and his two minor sons of all the properties and the businesses carried on by the family when it was joint. The houses and the three rubber estates allotted exclusively to M(I) were entered in the books of accounts opened in the name of "M.M.Ipoh" from the date of division. In Dece mber, 1941, A gave birth to a son CA. M(I) and CA then constituted a Hindu Coparcenary which owned the property and the business as allotted to M(I) in the partition of 1940. On December 30, 1949, a deed of partition was executed between M(I) and C, who had by then attained the age of majority, in respect of the businesses carried on in the name of "M.S.M.M.". The businesses were thereafter carried on in p artnership between M(I) representing himself and the minor CA and C, M(II) were admitted for the benefits of the partnership. In April, 1950, partition was effected between M(I) and CA and a deed of partition regarding the terms of partition was executed by M(I) and A acting as guardian of CA. In 195 1, M(I) acceded to a demand by C on behalf of the M.S.M.M. Firm for a half share in 'M.M.Ipoh Properties'. There was however no division of the properties by metes and bounds and the management of those properties as a single unit continued to remain with M.S.M.M. Firm as before. When assessed to Income-tax for the years 1951-52 to 1953-54 and 1954-55 to 1956-57, proceeding on the basis that there was association of persons styled "M.M.Ipoh", the same

was opposed. The court ruled that a firm is a person within the meaning of the Income-tax Act and a firm and an individual or group of individual may form an association of persons within the meaning of Section 3 of the Incometax Act. In that case, the Court observed as under,

"There is nothing in the Act which indicates that a minor cannot become a member of an association of persons for the purposes of the Act. .... In Commr. Of Income-tax, Bombay North, Kutch and Saurashtra v. Indira Balkrishna, (1960) 39 ITR 546: (AIR 1 960 SC 1172) it was held "that the word "associate" means, . . . 'to joint in common purpose, or to joint in an action'. Therefore, an association of persons must be one in which two or more persons join in a common purpose or common action, and as the words occur in a section which imposes a tax on income, the association must be one the object of which is to produce income, profits or gains." "

On the basis of the above ruling, we have no hesitation to hold that there is no substance in the submission made by the learned counsel for the petitioners.

11. We are also inclined to point out three other circumstances in this case. Firstly, in the affidavit filed, the first petitioner has nowhere claimed that before or even after obtaining majority he was not paid any amount representing the profit in the business. That being so, the first petitioner cannot escape by merely saying that he was not aware about the business.

The other aspect is that the petitioner in the affidavit filed in support of the writ petition in ground (C) has made a pleading to the effect that his father has not joined in any partnership business, which would only show that he would go to any extent to escape from his liability and also help others.

Thirdly, from the records we find that the petitioners as well as the late Viswambaran, who is the father of the first petitioner and husband of the second petitioner had been living in the very same house till the death of Viswambaran and even thereafter these petitioners continue to live in the same house.

12. To sum up, we do not find any substance in the submission made by the learned counsel for the petitioner that a minor cannot become a member of an association and that on that ground the writ petition has to be allowed at least so far as the first petitioner is concerned.

13. In the result, there are no merits in the writ petition and consequently the same is dismissed with costs of Rs.5,000/- payable to the first respondent herein. Connected W.P.M.P.No.54912 of 2002 is also dismissed.

vr

To

1. The Commercial Tax Officer, Thirunelveli P.O.,
Thirunelveli District, Tamilnadu.

2. The Deputy Tahsildar, Revenue Recovery,
Revenue Recovery Office, Thiruvananthapuram.

3. The District Collector, Collector's Office,
Thiruvananthapuram.

4. The Registrar, Tamilnadu Taxation Special Tribunal,
Singaravelar Maligai, Second Floor, Rajaji Salai,
Chennai - 1.