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AGARWAL AND CO.

v.

COMMISSIONER OF INCOME-TAX, U.P.

April 7, 1970

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[J. C. SHAH, K. S. HEGDE AND A. N. GROVER, JJ.]

Income-tax Act, 1922, s. 26A—Whether I.T.O. should register if section and the rules are complied with—Whether I.T.O. can go behind partnership deed—Section 2(9)—Definition of 'person' including Hindu Undivided Family—If could be imported into Partnership Act, 1932.

C

Partnership Act, 1932, s. 4—Partners, who can be—Association of Persons if 'person' within meaning of section.

Hindu undivided family—If can enter into partnership with others.

D

A firm consisted of 18 partners. The partnership deed did not show that any of the partners joined the deed as representatives of their Hindu Undivided Families. The firm applied for registration under s. 26A of the Income-Tax Act, 1922. The Income-tax Officer, the Appellate Assistant Commissioner and the Tribunal were of the opinion that some partners of the firm, having entered into the partnership as representatives of their respective Hindu undivided families, in view of section 4(3) of the Companies Act, 1913, the adult members of these families should be taken into consideration for determining whether or not the total number of partners exceeded twenty. On that basis they arrived at the conclusion that the firm had more than 20 partners and the same having not been registered as a company under the Companies Act, the partnership was unlawful. The High Court answered a reference made to it in favour of the revenue. In the appeal to this Court it was contended; (i) Section 4(3) of the Companies Act, 1913 proceeded on the erroneous impression that a joint Hindu Family can enter into a partnership which in law it cannot as it has no legal personality; (ii) it was not open to the Income Tax Officer to go behind the deed for the purpose of registration under s. 26A and (iii) if the application for registration complied with the requirements of that section and the rules made thereunder, it was not open to the Income Tax Officer to refuse to register. Allowing the appeal,

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HELD: (i) It is only partnership constituted according to the provisions of the partnership Act that can be considered as partnership under the Act. Under the Partnership Act only "persons" can join as partners. An association of persons is not a person within the meaning of that expression in the Partnership Act. The definition of "person" in the Income Tax Act including within the definition Hindu Undivided Family is intended for levying income-tax and other cognate matters and cannot be imported into the Partnership Act, the provisions of which alone are relevant for finding as to who could join as partners. A Hindu undivided family cannot as such enter into a contact of Partnership with another person or persons. The concept of a Hindu undivided family joining a partnership presents considerable difficulty. It is a fleeting body and such a partnership is likely to have a precarious existence. Therefore, the assumption in s. 4(3) of the Companies Act, 1913, that a Hindu Joint Family can be a partner in a partnership appears to be based on an erroneous view of the law. [241 H, 242 G-H]

Senaji Kapurchand v. Pannaji Devichand, A.I.R. 1930 P.C. 300, *Dulichand Laxminarayana v. Commissioner of Income-tax Nagpur*, 29 I.T.R. 535 and *Commissioner of Income-tax West Bengal v. Kalu Babu Lal Chand*, (1959) 37 I.T.R. 23, referred to.

Lala Lachman Das v. Commissioner of Income Tax, 74 I.A. 277, distinguished.

(ii) For the purpose of finding out as to who are all partners of a firm, one has only to look to the partnership deed and not to go behind it. It is well settled that when a co-parcener, even when he is the Karta, enters into partnership with others the partnership that is created is a contractual partnership; that partnership is not between the family and the other partners; it is a partnership between the coparcener individually and his other partners. [244 B-C]

P. K. P. S. Pichappa Chettiar v. Chokalingam Pillai, A.I.R. 1934 P.C. 192, *Kshetra Mohan-Sannyasi Charan Sadhukhan v. Commr. of Excess Profits Tax, West Bengal*, (1953) 24 I.T.R. 488, *Firm Bhagat Ram Mohan Lal v. Commissioner of Excess Profits Tax, Nagpur and Anr.* (1956) 29 I.T.R. 521 and *Commissioner of Income-tax, Bombay City v. Nandlal Gandadal*, (1960) 40 I.T.R. 1, referred to.

(iii) The Income-tax Officer has no power to reject an application for registration under s. 26A if the provisions of the section and the rules framed thereunder are complied with. The jurisdiction of the Income-tax Officer is confined to ascertaining two facts, namely, (1) whether the application for registration is in conformity with the rules framed under the Act and (2) whether the firm shown in the document was a bogus one or had no legal existence. It is not open to the Income-tax Officer to go behind the deed and find out for the purpose of registration whether the partners mentioned in the deed have joined the partnership in their own right or as representing others. In the present case the application made for registration complies with the requirements of the section and the rules framed thereunder. Hence the partnership must be held to have been validly formed as law did not at the relevant time prohibit anyone, otherwise competent to contract from entering into a contract of partnership even though the beneficial interest in his share may vest in others. [246 A-B, 247 E-F]

Commissioner of Income-tax, Madras v. Sivakashi Match Exporting Co. (1954) 53 I.T.R. 204 and *Commissioner of Income-Tax Gujarat v. A. Abdul Rahim and Co.*, (1965) 55 I.T.R. 651, referred to.

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 2200, 2200A and 2200B of 1968.

Appeals from the judgment and order dated November 30, 1967 of the Allahabad High Court in Income-tax Reference No. 366 of 1963.

M. C. Chagla and *P. N. Tiwari*, for the appellant (in all the appeals).

B. Sen, *G. L. Sharma* and *R. N. Sachthey*, for the respondent (in all the appeals).

A The Judgment of the Court was delivered by

Hegde J.—In these appeals by certificate the question that falls for decision is whether on the facts and in the circumstances of the case registration under s. 26(A) of the Indian Income Tax Act, 1922 (to be hereinafter referred to as the act) was rightly refused to the appellant firm on the ground that the partnership in question violated the provisions of s. 4 of the Indian Companies Act, 1913.

The authorities under the Act as well as the High Court of Allahabad have answered that question in the affirmative. The assessee challenges that conclusion.

C The above appeals relate to different assessment years of the same assessee, the relevant assessment years being 1952-53, 1953-54 and 1954-55. In all these years the Income Tax Officer had refused to register the appellant firm under s. 26A.

D All the partnership deeds are, we are told, similar in terms. We have before us the deed executed on July 7, 1950. It shows that the firm consists of 18 partners. *Ex facie* that deed does not show that any of the partners had joined the deed as representatives of their Hindu Undivided Families. From the tenor of the document, they appear to be partners in their own right. The Income Tax Officer, the Appellate Assistant Commissioner and the Tribunal have come to the conclusion that some of them had joined the partnership as Kartas of their respective Hindu Undivided Families. All the authorities under the Act as well as the High Court have opined that the partnership in question is not lawful in view of s. 4(3) of the Indian Companies Act, 1913. The material portion of that provision reads :

F “(4). (1)

G (2) No company, association or partnership consisting of more than twenty persons shall be formed for the purpose of carrying on any other business that has for its object the acquisition of gain by the company, association or partnership or by the individual members thereof, unless it is registered as a company under this Act, or is formed in pursuance of an Act of Parliament of the United Kingdom or some other Indian law or Royal Charter or Letters Patent.

H (3) This section shall not apply to a joint family carrying on joint family trade or business and where two or more such joint families form a partnership, in computing the number of persons for the purpose of this section, minor members of such families shall be excluded.

(4) Every member of a company, association or partnership carrying on business in contravention of this section shall be personally liable for all liabilities incurred in such business.

(5)

The Income Tax Officer, the Appellate Assistant Commissioner as well as the Tribunal were of the opinion that some partners of the assessee firm having entered into the partnership as representatives of their respective Hindu Undivided Families, the adult members of those families should be taken into consideration for determining whether or not the total number of partners exceeded twenty. On that basis they have arrived at the conclusion that the firm has more than twenty partners and the same having not been registered as a company under the Companies Act, nor having formed in pursuance of an Act of Parliament of the United Kingdom or some other Indian law or Royal Charter or Letters Patent, it must be held to be an unlawful partnership. When the question formulated earlier was referred to the High Court under s. 66(1) of the Act, it was heard by Jagdish Sahai and Beg, JJ. Jagdish Sahai J. was of the opinion that the partnership in question was not lawful. Beg J. differed from him and answered the question in favour of the assessee. In view of this difference of opinion, the matter was referred to Takru J. He agreed with Jagdish Sahai J. By a majority the question referred to the High Court was answered in favour of the revenue. Hence these appeals.

Mr. Chagla appearing on behalf of the assessee urged that no Hindu joint family as such can join a partnership and it is now well settled that when a karta of Hindu Undivided Family joins a firm as a partner even if he contributes his share from out of the family funds, the other members of his family do not *ipso facto* become partners of that firm. So far as the partnership is concerned, he is the only partner though he may be accountable to the members of his family as regards the profits earned. According to the learned counsel, for the purpose of working out the rights and liabilities of the partners *inter se* one cannot go behind the partnership deed. Proceeding further he urged that in considering whether a partnership should be registered under s. 26A or not, the Income-tax Officer has merely to see whether the requirements of s. 26A of the Act and the relevant rules are complied with or not. He is not entitled to investigate into the question as to who are beneficially interested in the partnership. According to him if the requirements of s. 26A and the relevant rules are complied with, the Income-tax Officer is bound to register the partnership. The counsel urged that the second limb of s. 4(3) of the Indian Companies Act, 1913, proceeds on the erroneous impression that

- A a joint Hindu family can enter into a partnership, which in law it cannot as it has no legal personality.

B Mr. B. Sen, learned counsel for the department did not contest the position that when a karta or a member of a Hindu Joint family joins a partnership the other members of his family do not become partners *ipso facto*. But according to him it is open to the department to go behind the partnership deed and find out whether the individual who has joined as a partner has joined in his own right or as a representative of any other body. His contention was that in view of s. 4(3) of the Indian Companies Act, 1913, once the Income-tax Officer comes to the conclusion that one of the partners of a firm is a representative of a joint family, he must deem that the adult members of that family are also partners of that firm and on that basis find out whether the total number of partners exceed twenty. If they exceed twenty he cannot register the partnership, as such a partnership contravenes s. 4(2) of the Indian Companies Act, 1913.

- C
D Section 2(6B) of the Act provides that the expression 'firm', 'partner' and 'partnership' in the Act have the same meaning respectively as in the Indian Partnership Act, 1932.

Section 4 of the Partnership Act, 1932 prescribes :—

- E "Partnership" is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

Persons who have entered into partnership with one another are called individually "partners" and collectively "a firm" and the name under which their business is carried on is called the 'firm name'.

- F In view of the aforementioned provision only "persons" can join as partners. Section 2(42) of the General Clauses Act says a "person" shall include any company or association or body of individuals whether incorporation or not. But this definition applies when there is nothing repugnant in the subject or context. After examining the provisions of the Partnership Act, the Privy Council in *Senaji Kapurchand v. Pannaji Devichand*⁽¹⁾, and this Court in *Dulichand Laxminarayana v. Commissioner of Income Tax, Nagpur*⁽²⁾, have held that an association of persons is not a person within the meaning of that expression in the Partnership Act. It is true that s. 2(9) of the Act says that unless the context otherwise requires "person" includes Hindu Undivided Family. This definition cannot be imported into the Partnership Act, the provisions of which alone are relevant for finding as to who could join as partners. It is only partnership constituted according to

the provisions of the Partnership Act that can be considered as partnerships under the Act. The definition of 'person' in the Act is intended for the purpose of levying income-tax and for other cognate matters.

On the basis of certain observations of the Judicial Committee in *Lala Lachman Das v. Commissioner of Income Tax*⁽¹⁾, it was contended on behalf of the department that a joint Hindu family can enter into a partnership. Those observations have to be read in the context in which they were made. The department in that case had requested the tribunal to refer the question "can there be a partnership within the meaning of s. 2 sub-s. 6(B) of the Indian Income-tax Act, 1922 between a Hindu Undivided Family as such on the one part and one of its undivided members in his individual capacity on the other part." But that question was ultimately not referred as being unnecessary on the facts of the case. But the following observations of the Judicial Committee in its judgment are relevant :

"It is unnecessary to consider in this case the question relating to the validity of a partnership between a Hindu Undivided family as such of the one part and one of its undivided members in his individual capacity of the other. With reference to the latter kind of partnership there seems to be some authority favouring the view that such a partnership cannot exist under the rules of Hindu law but their Lordships do not propose to deal with that question in this case."

In that case the partnership was between the karta of a joint Hindu family and an undivided member of that family. Hence the observations in the judgment that the Hindu Undivided family was a partner has really reference to the karta who was a partner as representing the family. In *Commissioner of Income-tax, West Bengal v. Kalu Babu Lal Chand*⁽²⁾, this Court observed that it is now well settled that Hindu Undivided Family cannot as such enter into a contract of partnership with another person or persons. Several other decisions have taken the same view. No decision taking a contrary view was brought to our notice. The concept of a Hindu Undivided Family joining a partnership presents considerable difficulty. A Hindu Undivided Family is a fleeting body. Its composition changes by births, deaths, marriages and divorces. Such a partnership is likely to have a precarious existence. The assumption in s. 4(3) of the Companies Act, 1913 that a Hindu Joint family can be a partner in a partnership appears to be based on an erroneous view of the law.

(1) 74. I.A. 277.

(2) (1959) 37, I.T.R. 23.

A The next question is whether when a deed of partnership does not on the face of it show that any Hindu Undivided Family has joined the partnership, is it open to the Income-tax Officer to go behind the deed and find out for the purpose of registration under s. 26A whether the ostensible partner is the representative of someone else.

B The Judicial Committee in *P. K. P. S. Pichappa Chettiar and Ors. v. Chokalingam Pillai and Ors.*⁽¹⁾ ruled that where a managing member of a joint family enters into a partnership with a stranger, the other members of the family do not *ipso facto* become partners in the business so as to clothe them with all the rights and obligations of a partner as defined by Contract Act. In such a case the family as a unit does not become a partner but only such of its members as in fact enter into contractual relationship with the stranger.

C In *Kshetra Mohan-Sannyasi Charan Sadhukhan v. Commr. of Excess Profits Tax, West Bengal*,⁽²⁾ this Court laid down that a Hindu Undivided Family is included in the expression "person" as defined in the Indian Income-tax Act but it is not a juristic person for all purposes; when two kartas of Hindu Undivided Families enter into a partnership agreement, the partnership though popularly known as one between two Hindu Undivided Families in the eye of the law, it is a partnership between the two kartas and the other members of the families do not *ipso facto* become partners; there is, however, nothing to prevent the individual members of one Hindu Undivided Family from entering into a partnership with the individual members of another Hindu Undivided Family and in such a case it is a partnership between the individual members and it is wholly inappropriate to describe such a partnership as one between two Hindu Undivided Families.

E In *Firm Bhagat Ram Mohan Lal v. Commissioner of Excess Profits Tax, Nagpur and anr.*⁽³⁾, this Court ruled that when the karta of a joint family enters into a partnership with the stranger, the members of the family do not *ipso facto* become partners in that firm. They have no right to take part in its management or to sue for its dissolution. The creditors of the firm would no doubt be entitled to proceed against the joint family assets including the shares of the non-partner co-parceners for realisation of their debts. But that is because under the Hindu law, the karta has the right when properly carrying on business to pledge the credit of the joint family to the extent of its assets, and not because the junior members become partners in the business. The liability

(1) A.I.R. 1934, P.C. 192.

(2) (1953) 24, I. T. R. 488.

(3) (1956) 29, I.T.R. 521.

of the latter arises by reason of their status as coparceners and not by reason of any contract of partnership by them.

— In *Commissioner of Income-tax, Bombay City v. Nandlal Gandalat*⁽¹⁾, this Court again observed that the position in Hindu law with regard to a coparcener, even when he is the karta, entering into partnership with others in carrying on a business is well settled. The partnership that is created is a contractual partnership and is governed by the provisions of the Indian Partnership Act, 1932. The partnership is not between the family and the other partners; it is a partnership between the coparcener individually and his other partners. The coparcener is undoubtedly accountable to the family for the income received, but the partnership is exclusively one between the contracting members, including the individual coparcener and the strangers. On the death of the coparcener, the surviving members of the family cannot claim to continue as partners with the others or institute a suit for dissolution of partnership; nor can the stranger partners sue them as partners for the coparcener's share of the loss. Therefore, so far as the partnership is concerned, both under partnership law and under Hindu law, the control and management is in the hands of the individual coparcener who is the partner, and not in the family.

In *Commissioner of Income-tax, Madras v. Bagyalakshmi and Co. Udamalpet*⁽²⁾, this Court observed that contract of partnership has no concern with the obligation of the partners to others in respect of their shares of profit in the partnership. It only regulates the rights and liabilities of the partners. A partner may be the karta of a joint Hindu family, he may be a trustee, he may enter into sub-partnership with others, he may under an agreement express or implied, be the representative of a group of persons; he may be a benamidar for another. In all such cases he occupies a dual position *qua* the partnership he functions in his personal capacity; *qua* the third parties in his representative capacity; third parties, whom one of the partner represents, cannot enforce their rights against the other partners nor can the other partners do so against the said third parties. Their right is only to a share in the profits of their partner-representative in accordance with law or in accordance with the terms of the agreement, as the case may be. The law of partnership and Hindu law function in different fields. A divided member or some of the divided members of the erstwhile joint family can certainly enter into a partnership with third parties under some arrangement among the members of the divided family. Their shares in the partnership depend on the terms of the partnership; the shares of the members of the divided

(1) (1960) 40 I.T.R.1.

(2) [1962] 2 S.C.R. 22.

- A** family in the interest of their representative in the partnership depend upon the terms of the partition deed.

From these decisions it follows that for the purpose of finding out as to who are all partners of a firm, one has only to look to the partnership deed and not to go behind it.

- B** Another contention urged by Mr. Chagla was that the scope of the enquiry under s. 26A is a limited one; if the application made for registration complies with the requirements of that section and the rules framed thereunder, then it is not open to the Income-tax Officer to refuse to register the firm. Section 26A says :

- C** “(1) Application may be made to the Income-tax officer on behalf of any firm, constituted under an instrument of partnership specifying the individual shares of the partners, for registration for the purposes of this Act and of any other enactment for the time being in force relating to the Income-tax or super-tax.

- D** (2) The application shall be made by such person or persons, and at such times and shall contain such particulars and shall be in such form, and be verified in such manner, as may be prescribed and it shall be dealt with by the Income-tax Officer in such manner as may be prescribed.”

- E** The conditions of registration prescribed in this section and the relevant rules are : (1) on behalf of the firm, an application should be made to the Income-tax Officer by such person and at such times and containing such particulars, being in such form and verified in such manner as are prescribed by the rules; (2) the firm should be constituted under an instrument of partnership; (3) the instrument must specify the individual shares of the partners and (4) the partnership must be valid and genuine and must actually exist in the terms specified in the instrument. If all the above conditions are fulfilled, the Income-tax Officer is bound to register the firm unless the assessee has contravened s. 23(4) of the Act.

- F** In *Commissioner of Income-Tax, Madras v. Sivakashi Match Exporting Co.*⁽¹⁾ this Court held that the combined effect of s. 26A and the rules made thereunder was that the Income-tax Officer could not reject an application made by a firm if it gave the necessary particulars prescribed by the rules and if there was a firm in existence as shown in the instrument of partnership. A firm is said to be not in existence if it was a bogus and not a

(1) [1954] 53 I.T.R. 204.

genuine one or if in law the constitution of the partnership was void. The jurisdiction if the Income-tax Officer was, therefore, confined to ascertaining two facts namely (1) whether the application for registration was in conformity with the rules framed under the Act and (2) whether the firm shown in the document presented for registration was a bogus one or had no legal existence. Further the discretion conferred on the Income-tax Officer under s. 26A was a judicial one and he could not refuse to register a firm on mere speculation. He had to base his conclusion on relevant evidence. Therein this Court further held that there was no prohibition under the Partnership Act against a partner or partners of other firms combining together to form a separate partnership to carry on a different business. The fact that such a partner entered into sub-partnership with others in respect of his share did not detract from the validity of the partnership; nor was the manner in which he dealt with his share of the profits of any relevance to the question of the validity of the partnership.

In *Commissioner of Income-Tax Gujarat v. A. Abdul Rahim and Co.*⁽¹⁾, this Court ruled that registration of a partnership deed under s.26A of the Act could not be refused on the ground that one of the partners was a benamidar for someone else. Therein this Court observed that it is a settled law that if a partnership is a genuine and valid one, the Income-tax Officer has no power to reject its registration if the other provisions of s.26A and the rules framed thereunder are complied with. When a firm makes an application under s.26A for registration, the Income-tax Officer can reject the same if he comes to the conclusion that the partnership is not genuine or the instrument of partnership does not specify correctly the individual share of the partners. But once he comes to the conclusion that the partnership is genuine and a valid one, he cannot refuse registration on the ground that one of the partners is a benamidar of another. If the partnership is genuine and legal, the share given to the benamidar will be the correct specification of his individual share in the partnership. The beneficial interest in the income pertaining to the share of the said benamidar may have relevance to the matter of assessment but none in regard to the question of registration. His beami character does not affect the benamidar's capacity as partner or his relationship with the other members of the partnership. If a partner is only a benamidar for another, it can only mean that he is accountable to the real owner for the profits earned by him from and out of the partnership. Therefore a benamidar is a mere trustee of the real owner and he has no beneficial interest in the property or the business of the real owner. But, in law, just as in the case of a trustee, he can also enter into a partnership with

(1) (1965) 55, I.T.R. 651.

- A others. The benamidar of a partner, *qua* the other partners, has separate and real existence; he is governed by the terms of the partnership deed, his rights and liabilities are governed by the terms of the contract and by the provisions of the partnership Act; his liability to third parties for the acts of the partnership is co-equal with that of the other partners; the other partners have
- B no concern with the real owner; they can only look to him for enforcing their rights or discharging their obligations under the partnership deed. Any internal arrangement between him and another is not governed by the terms of the partnership; that arrangement operates only on the profits accruing to the benamidar; it is outside the partnership arrangement. If a benamidar
- C possesses the legal character to enter into a partnership with another, the fact that he is accountable for his profits to, and has the right to be indemnified for his losses by a third party or even by one of the partners does not discharge him of the said character.

- As mentioned earlier, the persons who are shown in the partnership deed with which we are concerned in these appeals as
- D partners, appeared to have joined the same in their individual capacity. There is nothing in the partnership deed to indicate that they have joined the partnership as kartas of their respective families. It was not open to the Income-tax Officer to go behind the deed and find out, for the purposes of registration under s. 26A whether the partners mentioned in the deed have joined the partnership in their own right or as representing others. Hence the
- E partnership must be held to have been validly formed as law did not at the relevant time prohibit any one, otherwise competent to contract from entering into a contract of partnership even though, the beneficial interest in his share may vest in others. The application made for registration complies with the requirements of s. 26A and the rules framed thereunder. Therefore the Income-tax
- F Officer was bound to register the partnership.

- For the reasons mentioned above, we allow these appeals, set aside the order made by the High Court and answer the question referred to the High Court in the negative and in favour of the assessee. The department shall pay the costs of the assessee in
- G this Court as well as in the High Court. One hearing fee.

R.K.P.S.

Appeals allowed.