

A COMMISSIONER OF INCOME-TAX, AHMEDABAD

v.

A. ABDUL RAHIM & CO., BARODA

November 4, 1964

[K. SUBBA RAO, J. C. SHAH AND S. M. SIKRI, JJ.]

Income Tax Act, 1922, Section 26A registration of partnership—More than two partners—Otherwise genuine—Whether can be refused registration when one partner is benamidar.

Benamidar—Status of—If trustee of the real owner.

C A partnership consisting of three partners was reconstituted to take in a 4th partner who was a nephew of, and was given a part out of his own share by, one of the existing partners. The application by the new partnership firm for registration under s. 26-A of the Income-tax Act, 1922, was rejected by the Income-tax Officer on the ground that as the new partner was a *benamidar*, the partnership was not a genuine one. The Appellate Assistant Commissioner, the Appellate Tribunal and the High Court, all took the view that the new partnership agreement was valid in law and the fact that one of the partners was a *benamidar* of another was D not a sufficient ground for refusing to register the firm.

It was contended on behalf of the Revenue that apart from the fact that the 4th partner was a dummy and therefore the new partnership was not a genuine one, the actual share of the old partner was not what was stated in the agreement but was the total of his apparent share and that of the *benamidar*; to this extent the agreement did not contain a correct specification of the individual shares of partners as required under s. 26-A and registration was, therefore, rightly rejected.

HELD : (dismissing the appeal)

(i) When a firm makes an application under s. 26-A of the Act for registration, the Income-tax Officer can reject the application if he comes to the conclusion that the partnership is not genuine or the instrument of partnership has not specified correctly the individual shares of the partners. But once he comes to the conclusion that the partnership is a genuine and F 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 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 non in regard to the question of registration. [21D-F]

G *R. C. Mitter & Sons v. C.I.T., Calcutta*, (1959) Supp. 2 S.C.R. 641; *C.I.T. Madras v. Sivakasi Match Exporting Co.*, (1964) 53 I.T.R. 204; *Sir Sunder Singh Majithia v. C.I.T. C.P. & U.P.*, (1942) 10 I.T.R. 457, referred to.

The Central Talkies Circuit, Matunga, (1941) 9 I.T.R. 44, considered.

H *Hiranand Ramsukh v. C.I.T., Hyderabad*, (1963) 47 I.T.R. 598; *P. A. Raju Chettiar v. C.I.T., Madras*, (1949) 17 I.T.R. 51, distinguished.

(ii) A *benamidar* is a mere trustee of the real owner and has no beneficial interest in the property or the business of the real owner. As in the case of a trustee, he possesses the legal character to enter into a

partnership with another, and the fact that he is accountable for his profits to, and has a right to be indemnified for his losses by, a third party or even by one of the partners does not disgorge him to the said character. [19D-E, G-H] A

Gur Narayan v. Sheo Lal Singh, (1918), L.R. 46 I.A. 1, *Aruna Group of Estates, Bodinayakanur v. State of Madras*, (1962) 2 M.L.J. 264, referred to.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 982 of 1963. B

Appeal from the judgment and order, dated April 4, 5, 1961 of the Gujarat High Court in Income-tax Reference No. 8 of 1960.

K. N. Rajagopala Sastri and *R. N. Sachthey*, for the appellant. C

T. A. Ramachandran and *O. C. Mathur*, for the respondent.

The Judgment of the Court was delivered by

Subba Rao, J. This appeal by certificate raises the question whether the Income-tax Officer can refuse to register a genuine partnership entered into between more than 2 persons on the ground that one of them is only a benamidar for another. D

The relevant facts may briefly be stated. Three persons by name Abdul Rahim Valibhai, Abdulla Rehman and Abdul Rahim Malangbhai, constituted a partnership having 9 annas, 5 annas and 2 annas share respectively. The said partnership was carrying on business in goat and sheep skins. From the beginning of Samvat year 2012 (15-11-1955 to 2-11-1956) there was a change in the constitution of the said firm. A 4th partner by name Abdul Rehman Kalubhai was inducted into the partnership with 2 annas share carved out of the 9 annas share of Abdul Rahim Valibhai. The said Abdul Rehman Kalubhai is a nephew of Abdul Rahim Valibhai. On March 6, 1956, a partnership deed was executed between the said 4 persons. Under the said partnership, Abdul Rahim Valibhai, Abdulla Rehman, Abdul Rahim Malangbhai and Abdul Rehman Kalubhai had 7 annas, 5 annas, 2 annas and 2 annas share respectively. On May 8, 1956, the said firm presented an application to the Income-tax Officer for its registration under s. 26A of the Indian Income-tax Act, 1922, hereinafter called the Act. The Income-tax Officer held that the partnership was a bogus one and, on that finding, refused to register it. The assessee took up the matter on appeal to the Appellate Assistant Commissioner, who held that the partnership agreement was valid in law and that the fact that one of the partners was a benamidar of another was not a ground for refusing to register the firm, though E
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A it might entitle the Income-tax Officer to consider the income pertaining to the share of the benamidar as part of the income of the real owner in assessing the latter's income to tax. The Income-tax Officer questioned the correctness of the decision by preferring an appeal to the Appellate Tribunal, Bombay Bench. The Tribunal also held that the partnership was a genuine one and that the fact

B that one of the partners gave away a small part of his share to his nephew would not disqualify the partnership from being registered under s. 26A of the Act. At the instance of the Revenue the following question was referred to the High Court :

C "Whether a partnership in which one partner is the benamidar of another partner could be registered under s. 26A of the Indian Income-tax Act."

The learned Judges of the High Court thought that the question as framed did not really bring out the true matter in controversy between the parties and, therefore, they reframed the question as follows :

D "Whether on the facts and in the circumstances of the case, the partnership constituted under the instrument of partnership, dated 6th March 1956 could be registered under Section 26A of the Indian Income-tax Act."

E The learned Judges answered the question in the affirmative. They held that as the partnership was a genuine one the fact that one of the partners had no beneficial interest in his share by reason of some arrangement between him and another partner would not disentitle the firm from being registered under the Act. Hence the appeal.

Mr. Rajagopala Sastri, learned counsel for the Revenue, raised before us the following two points : (1) Abdul Rehman Kalubhai is only a dummy and therefore, the partnership is not a genuine one; (2) even if Abdul Rehman Kalubhai is a benamidar of Abdul Rahim Valibhai in respect of the 2 annas share in the partnership,

G Abdul Rahim Valibhai has in fact 9 annas share in the partnership; as the partnership deed shows that he has only 7 annas share instead of 9 annas share, there is no correct specification of his individual share within the meaning of s. 26A of the Act and, therefore, the Income-tax Officer rightly rejected the firm's application for registration under s. 26A of the Act.

H Learned counsel for the respondent, on the other hand, argued that the question whether the partnership was genuine or not is one of fact and indeed presumably for that reason the question

of genuineness was not referred to the High Court by the Tribunal and that the learned counsel for the Revenue cannot now raise that question before this Court. He further argued that, as the partnership is genuine, the circumstance that under some internal arrangement one of the partners is a benamidar of another partner will not detract from its validity or disqualify it from being registered under the Act.

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To appreciate the contentions it will be convenient at the outset to read the relevant part of s. 26A of the Act and also the rules made thereunder.

Section 26A. (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 income-tax or super-tax.

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(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.

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Rules 2 to 6B of the Rules made under s. 59 of the Act deal with the registration of firms.

Rule 2. Any firm constituted under an Instrument of Partnership specifying the individual shares of the partners may, under the provisions of section 26A of the Indian Income-tax Act, 1922 (hereinafter in these rules referred to as the Act), register with the Income-tax Officer, the particulars contained in the said Instrument on application made in this behalf.

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Such application shall be signed by all the partners personally.

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Rule 4. If, on receipt of the application referred to in Rule 3, the Income-tax Officer is satisfied that there is or was a firm in existence constituted as shown in the instrument of partnership and that the application has been properly made, he shall enter in writing at the foot of the instrument or certified copy, as the case may be, a certificate in the following form.

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- A** *Rule 6B.* In the event of the Income-tax Officer being satisfied that the certificate granted under Rule 4, or under Rule 6A, has been obtained without there being a genuine firm in existence, he may cancel the certificate so granted.
- B** On a consideration of the said provisions, among others, this Court in *R. C. Mitter & Sons. v. Commissioner of Income-tax, Calcutta*⁽¹⁾, speaking through Sinha, J., as he then was, held that in order a firm may be entitled to registration under s. 26A of the Act, the following essential conditions must be satisfied, viz.,
- C** (i) the firm should be constituted under an instrument of partnership, specifying the individual shares of the partners; (ii) an application on behalf of, and signed by, all the partners and containing all the particulars as set out in the Rules must be made;
- D** (iii) the application should be made before the assessment of the firm under section 23, for that particular year; (iv) the profits or losses if any of the business relating to the accounting year should have been divided or credited, as the case may be, in accordance with the terms of the instrument; and (v) the partnership must be genuine and must actually have existed in conformity with the terms and conditions of the instrument of partnership, in the accounting year. This Court again in *Commissioner of Income-tax, Madras v. Sivakasi Match Exporting Co.*⁽²⁾ held :
- E** “The jurisdiction of the Income-tax Officer is, therefore, confined to the ascertaining of two facts, namely,
- F** (i) whether the application for registration is in conformity with the rules made under the Act, and (ii) whether the firm shown in the document presented for registration is a bogus one or has no legal existence.”
- It is, therefore, 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 of the Act and the rules made thereunder are complied with.
- G** In the present case the partnership was found to be a genuine one. All the formalities prescribed by the rules have been complied with. The individual shares of the partners as shown in the Instrument of Partnership have been specified in the application. Therefore, unless there is some legal impediment in the way of a benamidar of one of the partners being a partner of the firm, the
- H** Income-tax Officer would not be exercising his jurisdiction if he rejected the application for registration.

(1) [1959] Supp. 2 S.C.R. 641.

(2) (1964) 53 I.T.R. 204, 209.

The first question, therefore, is whether the benamidar of a person can be a partner of a firm. Under s. 2(6B) of the Act, "firm", "partner" and "partnership" have the same meanings respectively as in the Indian Partnership Act, 1932 (IX of 1932) : provided that the expression "partner" includes any person who being a minor has been admitted to the benefits of partnership. Under s. 4 of the Indian Partnership Act, "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. If the partnership is genuine, as it is held in the present case, it follows that the 4 partners mentioned in the partnership deed must be held to have agreed to share the profits of the business carried on by them in the manner specified in the document. Indeed, in the present case the Instrument of Partnership and the application for registration contain clear recitals that the 4 partners have clear and definite shares in the profits of the firm.

The Judicial Committee in *Sir Sundar Singh Majithia v. Commissioner of Income-tax, C.P. & U.P.*⁽¹⁾ posed the question that arises for consideration of the Income-tax Officer under s. 26A of the Act. Sir George Rankin, speaking for the Board, said :

"When a document purporting to be an instrument of partnership is tendered under Section 26-A on behalf of a firm and application is made for registration of the firm as constituted under such instrument, a question may arise whether the instrument is intended by the parties to have real effect as governing their rights and liabilities *inter se* in relation to the business or whether it has been executed by way of pretence in order to escape liability for tax and without intention that its provisions should in truth have effect as defining the rights of the parties as between themselves. To decide that an instrument is in this sense not genuine is to come to a finding of fact :

In view of the finding given by the Tribunal that the Instrument of Partnership was genuine, it follows that it was not executed as a pretence in order to escape liability for tax, but in truth it defined the rights and liabilities of the parties between themselves.

This leads us to the question whether the benamidar can be in law a partner of a firm. In the context of the right of a benamidar to sue in his own name to recover immoveable property, the

(1) (1942) 10 I.T.R. 457, 461-462.

A Judicial Committee in *Gur Narayan v. Sheo Lal Singh*⁽¹⁾ defined the status of a benamidar in law thus :

B “As already observed, the benamidar has no beneficial interest in the property or business that stands in his name; he represents, in fact, the real owner, and so far as their relative legal position as concerned he is a mere trustee for him. The bulk of judicial opinion in India is in favour of the proposition that in a proceeding by or against the benamidar, the person beneficially entitled is fully affected by the rules of *res judicata*.”

C *In Aruna Group of Estates, Bodinayakanur v. State of Madras*⁽²⁾ a Division Bench of the Madras High Court, on the basis of the said legal position, rightly held that the benami character did not affect the benamidar’s capacity as partner or his final relationship with the other members of the partnership. It pointed out that

D “if any 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 others.

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If so, what is the principle of law which prohibits the benamidar of a partner from being also a partner along with the said partner with others? Qua the other partners, he 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

F 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 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 partner is not

G 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 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

H does not disgorge him of the said character.

(1) (1918) L.R. 46 I.A. 1, 9.

(2) (1962) 2 M.L.J. 294.

It is true that different considerations may arise, if the partnership is only between two persons of whom one is a benamidar of the other. In that event the partnership may be bad not because the benamidar has no power to enter into the partnership but because the partnership in law is the relationship between at least two persons and in the case of a benamidar and the real owner in fact there is only one person. It may also be that in a case where a benamidar is taken as a partner with the consent of the other partners, he will only be a "dummy". We do not propose to express any final opinion on the said two questions, as they do not arise in this appeal.

A Division Bench of the Bombay High Court in *The Central Talkies Circuit, Matunga, In re*⁽¹⁾ held that there was evidence to justify the finding of the Income-tax authorities that the alleged partnership was not a genuine partnership and that they acted rightly in refusing to register the firm. That finding was sufficient to dispose of the reference before the Court. But Beaumont, C.J., in the course of the judgment made some observations which lend support to the contention of the appellant. The learned Chief Justice said :

"Speaking for myself, I should say that if it were shown that one of the partners was only a nominee of a share allotted to him or her for another partner, the deed would not then specify correctly the individual shares. I think it must specify correctly the individual and beneficial shares, because that is a matter which is relevant from the point of view of the Income-tax authorities. If the Assistant Commissioner had any evidence before him to lead to the conclusion that the mother in the case was not really entitled to a beneficial interest of 4½ annas share, I think he was justified in refusing to register the deed."

With great respect, we cannot, agree with the said observations. If a benamidar has the character of a trustee and, therefore, can enter into partnership with another in his own name, the share allotted to him in the partnership must be held to specify correctly his individual share therein. Kania, J., as he then was, did not express any opinion on this aspect of the case. A Division Bench of the Andhra Pradesh High Court in *Hiranand Ramsukh v. Commissioner of Income-tax, Hyderabad*⁽²⁾ held that a person shown as a partner in a partnership deed was not a genuine partner and

(1) (1941) 9 I.T.R. 44, 52.

(2) (1963) 47 I.T.R. 598.

- A therefore the Income-tax Officer was perfectly justified in refusing to register the firm. There the assessee-firm originally consisted of 2 partners with equal shares, namely, Ramprasad and Bhagwandas. After the death of Bhagwandas, Ramprasad took his aunt, Mrs. Chandrabai, and his minor son as partners. The Income-tax Officer held that both Mrs. Chandrabai and Ramprasad's minor son were not genuine partners but were mere dummies, and they were shown merely as partners to reduce the incidence of tax. As two of the three partners were not genuine partners, the partnership itself was not genuine. Though some of the observations in the judgment are wide, that decision does not touch the present case. The decision of the Madras High Court in *P. A. Raju Chettiar v. Commissioner of Income-tax, Madras*⁽¹⁾ is also one where the finding was that the partnership was not a genuine one. That decision also is besides the point.

The legal position may be stated thus : When a firm makes an application under s. 26A of the Act 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 shares 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.

- F In the result, for the aforesaid reasons, we hold that the answer given by the High Court is correct. The appeal fails and is dismissed with costs.

Appeal dismissed.

(1) (1949) 17 I.T.R. 51.