(1953) 05 CAL CK 0026

Calcutta High Court

Case No: Income-tax Reference No. 23 of 1952

COMMISSIONER OF Income Tax, WEST BENGAL		APPELLANT
	Vs	
A. J. ELDER AND ANOTHER.		RESPONDENT

Date of Decision: May 15, 1953

Acts Referred:

- Income Tax Act, 1961 - Section 12B

Citation: (1954) 25 ITR 150

Hon'ble Judges: Chakravartti, C.J; Lahiri, J

Bench: Full Bench

Judgement

CHAKRAVARTTI, C.J. - Taken by itself the question referred in this case is one of an ordinary kind, turning, as it does, merely on the construction of two deeds. But the facts are rather out of the ordinary. It appears that the two assessees made use of the liberty which the law allowed them so to adjust their affairs as to minimise their tax liability and they made an attempt to transfer some capital assets in a way which might avert their liability for a tax on the capital gains made by them out of the transfer. The question is whether they succeeded.

The facts are simple and are as follows. There was a firm carrying on business in Calcutta, called Landale and Morgan, which at one time seem to have had many partners. By the beginning of the accounting year in question, viz., 1947-48, the two assessees before us came to be the sole partners. Then, with effect from October 1, 1947, they took in as partners eight outsiders who have been compendiously described as the Ajit Saria group. Although this was in fact done on and with effect from October 1, 1947, the relevant deeds were not executed till December 2 following. On that date, two documents were executed, one a deed of agreement and another a partnership deed. The decision of the question in the present case really turns on the construction of the first of those two deeds. The terms which specially concern this case are two in number. By one, the two assessees agreed and

undertook to sell portions of their shares in the capital and goodwill of the firm as at October 1, 1947, to the members of the Ajit Saria group and by the other, they agreed to sell further shares in the capital and goodwill of the same firm on April 1, 1948. The method adopted for effecting this transfer was an extremely ingenious one and of a compartmental character. By the first clause in the deed of agreement to which I have already referred, Daniel Smith agreed to sell 15 per cent. of his share in the capital and the goodwill of the firm for a consideration of Rs. 1,83,750 while James Elder agreed and undertook to sell 9 per cent. of his share for a consideration of Rs. 1,10,250. It was provided that the total of those two sums, namely, Rs. 2,94,000 would have to be paid to the vendors on the signing of the agreement.

It would thus appear that although expressed in the form of an agreement to sell, this clause in effect operated as a sale eo instanti.

The second clause was a little more complicated. By the first clause the two transferors had parted with only fractions of their shares in the capital and goodwill of the firm. By the second clause Daniel Smith agreed to sell a further 15 per cent. of his shares for a consideration of Rs. 1,83,625 and James Elder agreed to sell further 10 per cent for a consideration of Rs. 1,22,375. It was provided that the sale would take place on April 1, 1948, and the consideration would have to be paid then.

It will now appear that by the first clause the two assessees sold 24 per cent. of the total interest in the capital and goodwill of the firm to the Ajit Saria group and by the second clause they agreed to sell a further 25 per cent., making altogether a total of 49 per cent.

So much about the transfer of the capital and the goodwill. The deed of agreement dealt with profits as well and provided that even during the period between October 1, 1947, and April 1, 1948, the members of the Ajit Saria group would get 49 per cent. of the profits of the whole year, although it was expressed as 98 per cent. of the profits of the period in question. Thereafter too, their share in the profits would be the same. The distribution of the profits and the capital and the goodwill as set out in detail in clause 2 and 4 of the partnership deed is in accordance with the provisions of the deed of agreement which I have just summarised.

The reason why the transaction was arranged to take place in that manner may now be explained and it can be best explained by reference to the opening words of Section 12B of the Income Tax Act. That section provides :-

"The tax shall be payable by an assessee under the head Capital gains in respect of any profits or gains arising from the sale, exchange or transfer of a capital asset effected after the March 31, 1946, and before the April 1, 1948; and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange or transfer took place."

It was in order to place the receipt of the two sums of Rs. 1,83,625 and Rs. 1,22,375 after April 1, 1948, that the transfer by stages was arranged for. The section, as has been seen, operates only on transactions effected after March 31, 1946, and before April 1, 1948, and therefore if any capital gains were received from a transaction which took place not before April 1, 1948, but on that date itself, such gains would escape the tax liability imposed by Section 12B.

The Income Tax Officer refused to take the two deeds at their face value and held that in whatever dubious form they might have been cast, they operated to effect a transfer of the whole 49 per cent. in fact and in law on October 1, 1947. In aid of that conclusion, he relied chiefly on the fact that even during the period between October 1, 1947, and April 1, 1948, when the members of the Ajit Saria group were supposed to hold no more than 24 per cent. of the capital and the goodwill of the firm, they would get 49 per cent. of the profits. The Income Tax Officer thought that the measure of the profits of the Ajit Saria group was the measure of their real interest in the capital and the goodwill and therefore the latter was 49 per cent. even from October 1, 1947.

On appeal, the Income Tax Officer was upheld by the Appellate Assistant Commissioner but on further appeal they were both reversed by the Income Tax Appellate Tribunal. The Tribunal held that there was nothing in law to require that a partner of a firm should share the profits in the same proportion as his interest in the capital and goodwill of the firm. The fact that the members of the Ajit Saria group would be entitled to 49 per cent. of the profits during the period between October 1, 1947, and April 1, 1948, would therefore be no index of the extent of their interest in the capital and goodwill of the firm. In order to ascertain the measure of that interest, one had to refer to the terms of the two deeds and those deeds, in the view of the Tribunal, clearly operated to transfer only a 24 per cent. on October 1, 1947. The rest having been transferred on April 1, 1948, and the consideration for the 25 per cent. having also been received on the latter date, the amount, although capital gains, fell outside the provisions of Section 12B and was, therefore, immune from tax liability.

The Commissioner of Income Tax was dissatisfied with that decision and asked the Tribunal to refer a question of law to this Court. Upon his application, the Tribunal has referred the following question :-

"Whether on the facts and on a proper construction of the agreement and the partnership deed dated December 2, 1947, the sums of Rs. 1,16,215 and Rs. 1,74,385 representing the profit on sale of goodwill received on April 1, 1948, were liable for taxation for the assessment year 1948-49 u/s 12B of the Income Tax Act."

It will be noticed that the sums mentioned in the question are not the sums which were received for the 25 per cent. of the capital and the goodwill on April 1, 1948. The reason for the difference is that the sums mentioned in the question are the

amounts of profit made on the transaction, the balance being the price which the assessees themselves probably had had to pay for acquiring those shares. Section 12B is concerned only with the gains and therefore the figures in controversy are figures of the profit made on the transaction and not figures of the price of the shares.

Mr. Meyer, who has appeared on behalf of the Commissioner, contended that as soon as the members of the Ajit Saria group were admitted to the partnership, the old firm of Landale and Morgan was gone. The goodwill which the two assessees had purported to transfer was the goodwill of that firm. Mr. Meyers point was that no goodwill of a firm could possibly exist after the firm itself had ceased to exist and, therefore, although the two assessees could have transferred a portion of their goodwill in the old firm, at the time the firm was being reconstituted, they could not possibly have had any further goodwill of the old firm left in their hands which they could transfer on a subsequent date. The effect of that contention of Mr. Meyer was that what the two assessees had purported to transfer on April 1, 1948, had no existence either in fact or in law and, therefore, in effect they had transferred nothing.

It does not appear to me to be necessary to deal with the soundness of that contention of Mr. Meyer in the present case, because, as he himself admitted, even if full effect be given to it, he would not achieve his object of being able to bring in the two figures mentioned in the question under assessment. In order that those two sums may be taxable u/s 12B, it is not enough to establish that nothing was sold and could possibly have been sold on April 1, 1948, but it is necessary further to establish that what the assessees had purported to sale on April 1, 1948, had in law been already sold on October 1, 1947. Mr. Meyer frankly conceded that he found it impossible to contend that the latter propositions could be established.

It was not disputed in the present case that what was sold was a capital asset, nor was any question raised as to the genuineness of the transfer deeds. The motive of legal evasion, even if it had inspired the execution of the deed in the form in which they are found, was also admitted to be legitimate. The only question debated was whether the sale of the 49 per cent. of the shares of the two assessees could at all be so arranged as to take effect in two instalments.

As to that question, it appears to me that the construction of the deed of agreement presents no difficulty. The first clause, as I have already explained, operated as a present transfer and no question is involved in the present reference as regards the gains made on the transfer covered by that clause. So far as the second clause is concerned, it deals with a sale of "further shares". The relevant clause says quite clearly that the sale will take place on April 1, 1948. It also says that the consideration shall be paid on that date. It appears to me that although some difficulty may arise in a case where a partner of a firm sells his goodwill to a stranger who is to carry on business as a member of another firm or individually on

his own account, if such transfer is made by two instalments, I can see no difficulty in understanding a transaction of the present kind. In the hypothetical case which I have just assumed, the goodwill would have to be exploited by two different persons in respect of two independent concerns at the same time. The question may also arise as to whether after parting with a portion of goodwill of a firm which ceases to exist, the transferor can have anything left in him. But what took place in the present case, it appears to me, was only a distribution of the total interest in the capital and the goodwill of the firm as between the partners who came to become partners on October 1, 1947. It was an internal arrangement. If, as Mr. Meyer contended, no goodwill could exist independently after the firm, to which the goodwill related, had itself ceased to exist, that argument, it appears to me, would apply equally to the first transfer. On Mr. Meyers own argument, as soon as the eight members of the Ajit Saria group were taken in, the old firm of Landale and Morgan disappeared. If that was so, it appears to me that if the existence of the goodwill of a firm after the firm had ceased to exist be an impossible notion, there could not be any goodwill to be transferred even with effect from October 1, 1947. But quite apart from that argument, it appears to me that there is no bar in law to distributing or redistributing the interest in the capital and goodwill of a firm as between different partners. As pointed out by the Tribunal, the share in the capital or the goodwill need not determine the share in the profits. The only practical importance of a definite share in the goodwill is that on a dissolution of the firm, the partners will participate in the surplus assets in proportion to their shares in the capital and the goodwill of the dissolved firm. I do not, therefore see, anything inherently impossible in the transaction embodied in the deed of agreement in the present case.

That being so, the only question is, did 25 per cent. really pass to the transferees on April 1, 1948, or did it pass in law on October 1, 1947 ? I cannot see how the 25 per cent. could have passed earlier than April 1, 1948. Some force, either of law or arising out of the actings of the previous owners, would have to move the 25 per cent. from their hands into the hands of the transferees, and I can discover no such force either in the provisions of the deed of agreement or in the law relating to transfer. As I put it in the course of the argument, a simple test disclose that the 25 per cent. could not be taken to have been transferred earlier than April 1, 1948. If a dissolution of the firm took place between October 1, 1947, and April 1, 1947, it is not even arguable that the members of the Ajit Saria group would share in the capital assets of the firm to the extent of 49 per cent. As I have already stated, Mr. Meyer conceded that he could not establish that the 25 per cent. dealt with by clause 2 of the deed of the agreement was in fact transferred on October 1, 1947, and that unless he could establish such earlier transfer, the validity or effect of the purported transfer on April 1, 1948, could be of no interest or importance to him. Nothing would bring the capital gains made on the transfer of the 25 per cent. within the mischief of Section 12B, unless the transfer could be pressed into the

period lying between the limits of time mentioned in the section. Those gains cannot be so pressed and the result must be that they escaped the tax liability prescribed by Section 12B. In their plan for escaping tax, the assessees succeeded.

For the reasons given above, the answer to the question referred must, in my opinion, be in the negative.

I ought to state here that the reference comprises two cases, because the two assessees were independently assessed as they were bound to be. The two references were consolidated by consent.

The assessees will have the costs of this reference in equal shares. Certified for two counsel.

LAHIRI, J. - I agree.

Reference answered accordingly.