(1974) 11 CAL CK 0004

Calcutta High Court

Case No: F.M.A. No. 271 of 1973

Biju Patnaik		APPELLANT
	Vs	
Income Tax Officer, Central Circle		RESPONDENT

Date of Decision: Nov. 28, 1974

Acts Referred:

- Constitution of India, 1950 - Article 133(1), 226
- Income Tax Act, 1922 - Section 12B, 12B(2), 2(4A), 2(4C)
- Income Tax Act, 1961 - Section 142(1), 147, 148, 148(2), 151(2)

Citation: (1976) 1 ILR (Cal) 98

Hon'ble Judges: Sankar Prasad Mitra, C.J; S.K. Datta, J

Bench: Division Bench

Advocate: D. Pal, P.K. Pal and Ramendra Nath Dutta, for the Appellant;Balailal Pal and Sailendra Nath Dutta, for the Respondent

Final Decision: Allowed

Judgement

Sankar Prasad Mitra, C.J.

This is an appeal against a judgment of Chittatosh Mookerjee J. delivered on February 7, 1973, on an application under Article 226 of the Constitution. The Appellant prayed for the issue of relevant writs for quashing the notices dated July 31, 1965 and September 17, 1965, issued under Sections 148 and 142(1) of the income tax Act, 1961, for the assessment year 1957-58. The learned trial Judge has dismissed the application.

2. The Government of Orissa on October 10, 1952, granted a working permission to the Appellant to work certain mines for extraction of manganese ores for a period of one year from the date of delivery of possession of the land. The permission was renewable until finalisation of the terms and conditions of the deed of lease. The Government on January 14, 1954, granted another working permission to the

Appellant to extract iron ores from the same area. A further working permission was granted by the Government of Orissa in respect of iron ores on the August 30, 1955.

3. On March 19, 1956, B. Patnaik Mines (P.) Ltd. was incorporated and one of the objects of the company was to purchase or otherwise acquire as a going concern the business and goodwill of the firm of B. Patnaik Mine Owner as carried on by B. Patnaik, the Appellant. On March 23, 1956, B. Patnaik Mines (P.) Ltd. passed a resolution to the effect that the assets and goodwill of B. Patnaik Mine Owner would be taken over on or before March 31, 1956, on payment of Rs. 15 lakhs payable in suitable instalments. The agreement between the Appellant and Messrs B. Patnaik Mines (P.) Ltd. was executed, according to the aforesaid resolution, on March 23, 1956. Thereafter, there was correspondence between the Government of Orissa and B. Patnaik Mines (P.) Ltd. Ultimately, the Respondents'' case is, the transfer was approved by the Government of Orissa in accordance with the Mining Concession Rules on November 3, 1956. On January 21, 1959, the assessment of the Appellant for the assessment year 1957-58 was completed by the income tax Officer, ''A'' Ward, Cuttack and the total income was determined at Rs. 39,950. In this assessment the income tax officer did not seek to impose any capital gains tax on the sum of Rs. 15,00,000 which the Appellant had received on account of goodwill for transfer of his business aforesaid to B. Patnaik Mines (P.) Ltd. The reason was that the relevant provisions of Section 12B of the Indian income tax Act, 1922, attracting capital gains, came into force with effect from April 1, 1957. And since the Appellant''s case was that the transfer took place on March 31, 1956, the income tax Officer concerned did not impose any capital gains tax. The sum of Rs. 15,00,000 received in consideration of transfer of goodwill was not also shown in the Appellant''s income tax return for that year. In July 1965 the income tax Department wanted to issue a notice of reassessment under the provisions of Sections 147 and 148 of the income tax Act, 1961. Sub-section (2) of Section 148 requires that the income tax Officer shall, before issuing any notice under this section, record his reasons for doing so. The reasons recorded by the income tax Officer, Spl. IV Circle, Cuttack, dated July 2, 1965, are as follows:

The Assessee sold his mining business during the relevant accounting year to a company named M/s B. Patnaik Mines (P.) Ltd. and earned a profit of Rs. 15 lakhs which was assessable as capital gains but was not shown by the Assessee in his return. The transfer of the business was stated by the Assessee to have been made on 31-3-1956 and as such, the amount of capital gains was not liable to taxation, it was claimed by the Assessee since capital gains was not subjected to taxation in the assessment year 1956-57. But from information now available it appears that the transfer of the business took place on 3.11.56 and thus the Assessee was liable to be taxed on the capital gains earned in the accounting year ended 31.3.1957. Hence, action u/s 147(a) is required to assess the said sum of Rs. 15 lakhs which escaped assessment.

4. These reasons were placed before the Commissioner of income tax under the provisions of Sub-section (2) of Section 151. The Commissioner was satisfied that it was a fit case for issue of a notice u/s 148 read with Section 147(a) of the income tax Act, 1961. The notice u/s 148 was, accordingly, issued on July 31, 1965. This notice is under challenge in the present appeal. The other impugned notice, as we have said, is the notice u/s 142(1) which was issued on September 17, 1965, calling upon the Appellant to produce or cause to be produced the relevant documents.

5. There appears to be no dispute between the parties that the sum of Rs. 15,00,000 sought to be assessed was consideration received by the Appellant on account of transfer of the goodwill of his business. Clause 2 of the agreement dated March 31, 1956, reads thus:

That in consideration of the transfer of the vendor, the vendees agree to pay a sum of Rs. 15,00,000 (Rupees fifteen lacs only) in suitable instalments in course of 10 years and the vendees from now will be entitled to use the name of ''B. Patnaik, Mine Owner'' in their business transactions so long as they desire. The vendor shall not interfere and shall not compete under the name and style of ''B. Patnaik, Mine Owner'' in the mining business for a period of 10 years. Any right, title already accrued or acquired by the vendor in future by virtue of applications for mining lease and prospecting licence already filed with Orissa Government will be deemed to be the right and property of the vendees from today and the vendee will be deemed to be successors in business of the vendor for all purposes.

6. We repeatedly asked the learned Counsel for the Respondents as to whether he was contending that this was a colourable document or a mere contrivance. The learned Counsel stated to us that he had no desire to do so. We shall revert to this question of taxability of goodwill later. At the moment we propose to deal with the argument of the Appellant''s counsel that the reasons recorded by the income tax Officer, which we have noted above, are not sufficient for issue of a notice u/s 148. The learned Counsel for the Appellant submits that the income tax Officer merely communicates to the Commissioner that he has some information available to him and from that information it appeared that the transfer of the business took place on November 3, 1956. The income tax Officer does not give any particulars of this information. He does not indicate the sources of his information also. He has not given any facts, according to the Appellant''s counsel, which leads him to believe (a) that any income has escaped assessment and (b) that this escapement is due to the failure on the part of the Assessee to disclose fully and truly all material facts necessary for his assessment for the year 1957-58.

7. In Calcutta Discount Company Limited Vs. Income Tax Officer, Companies District, I and Another, and in a series of other decisions subsequent thereto, the Supreme Court has laid down that the only question in these cases for consideration by the Court is whether or not the income tax Officer has some reasonable grounds to believe that there had been any non-disclosure as regards the primary facts which

has a material bearing on the question of underassessment of income. If there are such reasons disclosed by the income tax Officer in his report to the Commissioner for sanction, it would be sufficient for assumption of jurisdiction to issue a notice u/s 148. The Court cannot go into or decide whether the income tax Officer''s grounds for reopening the assessment are adequate or not. The Supreme Court has further laid down that the income tax Officer in his recorded reasons need not give all the details or particulars of the case found by him on the basis whereof he proposes to reopen the assessment and it is open to him to clarify the basic facts disclosed in his reasons by affidavits filed in proceedings before the Court.

8. If we apply the above principles to the facts of the present case, we find that the basic ground for reopening of assessment has been clearly stated by the income tax Officer in his report. Originally, the Appellant claimed before the income tax Officer who made his assessment for the year 1957-58 that the transfer of the business took place on the March 31, 1956. In his reasons the income tax Officer has stated that he has information which had become available to him that the transfer took place on November 3, 1956. The statement as to the date of transfer appears to us to be definite, assertive and specific. This report of a responsible officer on whom the Commissioner has necessarily to rely, was placed before the Commissioner for his sanction. The Commissioner has applied his mind to the reasons and has given his sanction. For all these reasons it does not appear to us that the notice u/s 148 can be challenged on the ground that the reasons for reopening of assessment are not sufficient. Our conclusion is further justified by the affidavit which the original income tax Officer, who had made the assessment for 1957-58, has filed in these proceedings. This is the affidavit of Dilip Kumar Sen affirmed on June 16, 1967. In this affidavit in para. 2 the deponent states as follows:

...I deny that at the time of the original assessment for the relevant assessment years all the materials necessary and relevant for the said assessment years were produced before, me and the same were considered by me at the time of completion of the assessment. 1 say that the facts relating to the transfer of the mining business had not been disclosed fully and truly by the Petitioner at the time of the assessment. It was represented on behalf of the Petitioner that the above mining business of which the Petitioner was the proprietor had been transferred to a limited company of the name of B. Patnaik Mines (P.) Ltd., before 31st March, 1956 and on such misrepresentation by the Petitioner a capital gain of Rs. 15 lakhs was left out of the assessment for the assessment year 1957-58.

9. Now Sub-section (a) of Section 147 of the income tax Act, 1961, requires that the Assessee must disclose fully and truly all material facts necessary for his assessment. In the instant case, the Assessee did not disclose that although the agreement was made between him and B. Patnaik (P.) Ltd. on March 31, 1956, the actual transfer of the licence was not approved by the State Government till November 3, 1956. There is no doubt, on the facts of this case that, by reason of the

failure of the Assessee to disclose this material fact the sum of Rs. 15,00,000 escaped assessment, if it is liable to assessment at all. We are, therefore, of opinion that on the ground of insufficiency of the reasons which the income tax Officer had recorded the notice u/s 148 in the instant case cannot be struck down.

10. But we are faced with another difficulty. It is common case that the sum of Rs. 15,00,000 was the consideration for the transfer of the goodwill of the Appellant''s business. As to whether ''goodwill'' attracts capital gains tax, there are a series of decisions of different High Courts in India including a decision of our Court.

11. The first decision was of the Madras High Court in COMMISSIONER OF Income Tax, MADRAS Vs. K. RATHNAM NADAR., . It has, inter alia, been held in this case that goodwill is created by the trading activities of the Assessee and probably by the name he has earned and the goodwill he has created among his customers. Goodwill of a firm is an intangible asset and can be compared to a seed which is planted on the date the firm begins its business and sprouts and grows as the firm grows in its dealings, in its stature and in its reputation. It is difficult to say that it costs anything in terms of money for its coming into existence. Though goodwill is a capital asset, in the case of a goodwill of a business it cannot be said that it became the capital asset of the firm at any particular point of time. It is something which goes on slowly growing and perhaps waxing and waning also. What exactly is the value of the goodwill of a business at any point of time may have to be worked on a proper basis by cost accountants. The Madras High Court is of the view that Section 12B(2)(ii) of the income tax Act, 1922, suggests that capital gain arises only on transfer of a capital asset which has actually cost to the Assessee something. Such actual cost in the context of the income tax Act being cost in terms of money, it cannot apply to transfer of capital asset which did not cost anything to the Assessee in terms of money in its creation or acquisition. The Madras High Court has come to the conclusion that capital gains tax cannot be imposed on consideration received by sale of goodwill of the business.

12. The same conclusion was reached by our Court in a Division Bench judgment in Commissioner of Income Tax, W.B. III Vs. Chunilal Prabhudas and Co. (Defunct Firm), . This Court has said that in order to be taxable capital gain within the meaning of Section 12B of the income tax Act, 1922, there has to be (i) profit or gain, (ii) capital asset, (iii) arising out of and (iv) sale, exchange and relinquishment or transfer. It is difficult, according to this Court, to apply these tests to the case of goodwill. Goodwill is not any kind of usual capital asset with which a business is started. It is not a capital asset which can be divided into parts, fragments or fractions or entered on the stock-book or register of capital assets, nor can it, like capital asset, exist independently without the business itself and have any value apart from business usually associated with capital asset. Unlike capital assets, goodwill, as an asset, is indivisible and cannot be sold, transferred or dealt with in fragments or fractions. On the interpretation of Section 2(4A), Section 2(4C) and Section 12B and on their

express words and tenor, goodwill does not come within the obvious meaning of capital assets. To bring goodwill within the meaning of capital asset and make it taxable would be to tax by implication or by analogy or by a forced and artificial construction.

13. Incidentally, this judgment of the Calcutta High Court was delivered on September 11, 1969/long before the present notice u/s 148 of the income tax Act, 1961, was issued to the Appellant.

14. The next case is a case of the Delhi High Court in Jagdev Singh Mumick Vs. Commissioner of Income Tax, , in which also it was held that the amount paid on account of goodwill was not a capital gain and was not liable to tax u/s 12B.

15. The Kerala High Court also reached the same conclusion in Commissioner of income tax v. E.C. Jacob 89 I.R.T. 88. A Full Bench of the Kerala High Court has applied various tests to the connotation of goodwill and has expressed the view that the amount received by the Assessee towards the value of goodwill was not assessable to tax u/s 43 of the income tax Act, 1961.

16. We find, therefore, that the Madras, Calcutta, Delhi and Kerala High Courts are unanimously of opinion that the value of goodwill is not taxable as capital gains. In the instant case, the income tax Officer would be bound by the decision of this Court. In other words, he has to hold that the consideration which the Assessee has received by transfer of the goodwill of his business was not taxable u/s 12B of the Indian income tax Act, 1922. In other words, no income has escaped assessment and the first condition to be satisfied u/s 147(a) of the income tax Act, 1961, does not exist in the instant case. This is a jurisdictional fact and the income tax Officer cannot assume jurisdiction in the absence of this fact. From this point of view the notices under challenge in the instant proceeding have to be quashed.

17. Our attention has been drawn to a judgment of the Gujarat High Court in Commissioner of Income Tax, Gujarat Vs. Mohanbhai Pamabhai, . The Gujarat High Court seems to be of the view that in appropriate cases capital gains tax may be assessed in respect of goodwill. But this judgment cannot be followed by us in view of the decision we have referred to of our Court.

18. In the result, therefore, this appeal is allowed. The impugned notices are quashed and set aside. We direct the issue of appropriate writs for this purpose. There will be no order as to costs.

19. In view, however, of the difference of opinion noted above between the Madras, Calcutta, Kerala and Delhi High Courts on the one hand and the Gujarat High Court on the other, on the oral application of counsel for the Respondents, we grant leave to appeal to the Supreme Court under Article 133(1)(a) and (b) of the Constitution. In our opinion, the case involves a substantial question of law of general importance and needs to be decided by the Supreme Court, particularly in view of the different

views taken as aforesaid. Appropriate orders may be issued for leave to appeal to the Supreme Court.

20. Let operation of this order be stayed for eight weeks from date as-prayed for.

Salil Kumar Datta J.

21. I agree.