

(1977) 03 BOM CK 0040**Bombay High Court****Case No:** Income-tax Reference No. 69 of 1967

Commissioner of Income Tax,
Bombay City-III

APPELLANT

Michel Postel

Vs**RESPONDENT****Date of Decision:** March 7, 1977**Acts Referred:**

- Income Tax Act, 1922 - Section 12B
- Income Tax Act, 1961 - Section 45

Citation: (1978) 112 ITR 315**Hon'ble Judges:** R.M. Kantawala, C.J; V.D. Tulzapurkar, J**Bench:** Division Bench**Advocate:** R.J. Joshi, for the Appellant; R.J. Kolah, for the Respondent**Judgement**

Kantawala, C.J.

This matter lies in a very narrow compass and having regard to the settled position in law can be disposed of by a very short order.

2. Michel Postel, the assessee, was carrying on business since about 1949 as an individual in the name and style of France Indian United Laboratories. The business consisted of importing of purchasing and selling drugs and patent medicines. On May 1, 1959, a private limited company was incorporated entitled France Indian Pharmaceuticals Private Ltd. with a capital of Rs. 6 lakhs divided into 5,000 shares of Rs. 100 each. On July 4, 1959, the limited company entered into an agreement with the assessee for taming over the business till then run in the name of France Indian United Laboratories for a sum of Rs. 6 lakhs of which Rs. 1,99,151 is said to be for goodwill. The question arose whether any capital gains tax way payable in respect of the sale of goodwill to the limited company.

3. According to the Income Tax Officer, a sum of Rs. 2,35,572 was capital gains in respect of the said sale of goodwill. In an appeal by the assessee, the Appellate

Assistant Commissioner held that the value of goodwill as on January 1, 1954, was Rs. 62,556 and directed relief being given to this extent in the computation of capital gains. Both the revenue as well as the assessee filed cross-appeals against the order of the Appellate Assistant Commissioner. It is unnecessary to deal with the contentions that were urged by the respective parties before the Tribunal because those contentions were urged having regard to the position in law as then prevailing in view of judicial decisions. The Tribunal took the view that the assessee was right in his contention that the transaction by which the business came to be incorporated did not attract liability to tax u/s 12B which deals with capital gains. For coming to this conclusion the Tribunal relied upon two decisions of this court in the case of Commissioner of Income Tax v. Sir Homi Mehtas Executors, (Bom.) and in the case of [Rogers and Co. Vs. Commissioner of Income Tax, Bombay City-II,](#). In the first of these two cases, it was held by this court that though the assessee and his sons on the one hand and the private limited company formed by them were distinct entities in law, the real result of the formation of the company and the transfer of the shares to that company was only that instead of the shares being jointly held as individuals they were held by these very persons as a limited company; the so-called sale of the shares to the company was not a business activity entered into with the object of earning a profit and was not really a sale but merely a procedure adopted for readjustment of their position as holders of the shares; the assessee did not make any profit or gain in a commercial sense by transferring the shares to the company and the Income Tax authorities were not entitled to levy Income Tax on the difference between the market price and cost price of the shares merely because the market price of the shares at the time of transfer was higher than the cost price. The same principle was applied in the latter case of father and son and this court took the view that the transfer of the assets of the firm to the company was substantially and really merely a readjustment made by the members to enable them to carry on their business as a company rather than as a firm and no profits in the commercial sense was made thereby, the transfer of the assets of the firm to the company was, therefore, not a sale and the provisions of the second proviso to section 10(2)(vii) did not apply. Following these decisions the Tribunal took the view that there was no sale or transfer which could give rise to capital gain to the assessee taxable in his hands. It is against that order of the Tribunal that the revenue has asked for a reference for determination of the following question : "Whether, on the facts and in the circumstances of the case, the assessee was liable to tax on capital gains u/s 12B of the Indian Income Tax Act, 1922 ?"

4. Mr. Joshi on behalf of the revenue submitted that the decision of the Bombay High Court in the case of Commissioner of Income Tax v. Sir Homi Mehtas Executors, (Bom.) and in the case of [Rogers and Co. Vs. Commissioner of Income Tax, Bombay City-II,](#) have been overruled by the decision of the Supreme Court in [Commissioner of Income Tax, Gujarat Vs. B.M. Kharwar,](#) and he submitted that since this was the basis on which the finding of the Tribunal was given the question

referred to us may be answered in favour of the revenue. Mr. Joshi submitted that he is conscious that if a contention of law is raised that goodwill being a self-generated or self-created asset it does not attract capital gain, it should be left to the assessee to argue when the case is remanded back to the Tribunal. On the other hand, Mr. Kolah did not dispute the position that the decisions of the Bombay High Court in *Commissioner of Income Tax v. Sir Homi Mehtas Executors, (Bom.)* and *Rogers and Co. Vs. Commissioner of Income Tax, Bombay City-II*, had been overruled by the decision of the Supreme Court in *Commissioner of Income Tax, Gujarat Vs. B.M. Kharwar*. However, he urged that, on the facts stated in the statement of case, it is quite evident that the goodwill in the present case was a self-generated asset and there is a clear decision of this court in the case of *Commissioner of Income Tax, Bombay City-III Vs. Home Industries and Co.*. He, therefore, submitted that even though the basis on which the Tribunal decided in favour of the assessee could not be sustained in view of a later decision of the Supreme Court, still there is no possibility of capital gain being attracted in the present case as there is no transfer.

5. In view of the rival contentions, Mr. Joshi is right that the decision is *Commissioner of Income Tax, Gujarat Vs. B.M. Kharwar*, has overruled the view that has been taken by the Bombay High Court in *Commissioner of Income Tax v. Sir Homi Mehtas Executors, (Bom.)* and *Rogers and Co. Vs. Commissioner of Income Tax, Bombay City-II*. However, the question that we have to consider is whether Mr. Kolah should be prevented from contending that the goodwill from the facts stated in the statement of the case being a self-generated asset there is no question of transfer attracting tax and capital gain on sale of the goodwill.

6. The assessee, as the statement of case says, was carrying on business since about the year 1949, as an individual in the name and style of France Indian United Laboratories. If such a statement is closely dissected then a question may arise whether the assessee himself started the business in the year 1949 or he purchased the business and continued. It is clearly mentioned that the orders passed by the taxing authorities are forming part of the case. The statement of the Income Tax Officer in his order has clearly stated that the business was started by the assessee from January 1, 1949, and was showing losses which amounted to Rs. 1,32,475 in all. Thus the statement on which reliance is placed by Mr. Joshi has to be read in the light of what the Income Tax Officer has stated in his order. If that was so, then it is quite clear that the business which ultimately was sold by the assessee to the limited company under the agreement dated July 4, 1959, was started by the assessee himself on January 1, 1949. This court in the case of *Commissioner of Income Tax, Bombay City-III Vs. Home Industries and Co.*, has clearly held that having regard to the provisions of section 12B(1) of the Indian Income Tax Act, 1922, and section 45 of the Income Tax Act, 1961, the incidence of tax is on profit or gains arising from the transfer or sale of a capital asset. The concept of "profit or gain" arising from the transfer or sale necessarily implies that there is something received in excess of the

cost of the capital assets which is transferred or sold. The charging provision in both the Act itself brings in the concept of actual cost to the assessee of the capital asset and what is done by the machinery provision, which is contained in section 12B(2) of the 1922 Act and section 48 of the 1961 Act, is to elaborate that concept and lay down the mode or method by which such profit or gain is to be computed; the machinery provision reiterates what is contained in the charging provision and goes on to indicate the capital gain is to be arrived at after deducting the actual cost from the full value of the consideration for which the transfer of the capital asset is made. If the capital asset is such that it has cost nothing in terms of money to the assessee, the charging provision must be interpreted as being not referable to such capital asset and a self-created or self-generated goodwill being such asset, will be outside the purview of the charging section. Therefore, on a proper interpretation of the charging provision itself, it seems clear that the concept of actual cost expressed in terms of money to the assessee of the capital asset at some particular point of time would be a necessary ingredient before the transfer of that capital asset can give rise to chargeable gain. Since self-created or self-generated goodwill is not a capital asset which could be said to have been acquired by the assessee-firm at any particular point of time and is not a capital asset which could be said to have cost something in terms of money to the assessee, such goodwill will not be a capital asset, the transfer of which will give rise to chargeable capital gain u/s 12B(1) of the 1922 Act or section 45 of the 1961 Act. On the facts of that case, which were similar to the present case, this court held that there was no transfer or sale of goodwill to the private limited company so as to attract the provisions of section 12B(1) of the Indian Income Tax Act, 1922. Having regard to the clear statement made in the order of the Income Tax Officer which is forming part of the statement of the case that as the business was commenced and started by the assessee himself the goodwill was a self-generated asset and the question as to tax and capital gain being leviable when the business was transferred to the limited company is fully governed by the above decision and in view of that decision no tax on capital gain by way of transfer or sale of goodwill in such a case is payable.

7. In the result, our answer to the question referred is in the negative and in favour of the assessee. The revenue shall pay the costs of the assessee.