

(1975) 11 MAD CK 0044

In the Madras High Court

Case No : Tax Case No. 51 of 1970 (Reference No. 2 of 1970)

A. Subbiah Nadar

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 11-11-1975

Acts Referred:

Income Tax Act, 1961 — Section 41(2)

Citation : (1976) 104 ITR 564

Hon'ble Judges : V. Sethuraman, J; V. Ramaswami, J

Bench : Division Bench

Advocate : K. Ramagopal, for the Appellant; J. Jayaraman, for the Respondent

Judgement

V. Ramaswami, J.—The assessee was plying four lorries up to March 31, 1961. On and from April 1, 1961, a partnership firm consisting of the assessee, his two sons and his divided brother, one Kanniappan, was formed and this partnership firm took over the four lorries. In the return filed by the assessee for the assessment year 1962-63, he claimed his status as an individual and made a claim that he did not make any profit in the transaction by which the partnership firm took over the lorries. In the accounts of both the assessee and the partnership firm, the value of the lorries was shown at the original book value. At the time of assessment, however, the assessee filed an affidavit stating that due to mistake and ignorance, the value standing in the account of the lorries in his individual books was transferred as purchase price to the books of the firm and in doing so the actual market value of the lorries was not taken into account resulting in presenting a wrong picture of the assets. Treating that transaction as a sale by the assessee to the partnership firm, the Income Tax Officer considered that neither the cost price nor the written down value could be taken into account for determining the profits made u/s 41(2) of the Income Tax Act and that it will have to be computed only with reference to the market value as on April 1, 1961, when the firm took over the assets. He, accordingly, valued the market value of the four lorries at Rs. 45,000 and determined the profits

chargeable to tax u/s 41(2) at Rs. 29,185.

2. In the appeal filed by the assessee against this assessment, the Appellate Assistant Commissioner was of the view that the Income Tax Officer went wrong in computing the profits on the basis of the difference between the estimated market value and the written down value and it should have been assessed on the difference between the cost price and the written down value. Accordingly, after issuing a notice to the assessee he redetermined the profits chargeable to tax on the basis of the difference between Rs. 61,000, the cost price, and the written down value of Rs. 15,815.

3. The assessee preferred a further appeal to the Tribunal. Before the Tribunal, the assessee raised two additional grounds on which he contended that the lorries did not belong to the assessee exclusively ; but belonged to the joint family of himself and his sons and that. these assets continued to belong to the joint family even after they were taken up by the partnership. He also contended that the new partnership took up the transport business as a going concern and, therefore, no question of computation of profit could arise u/s 41(2). The Tribunal permitted the assessee to raise these two additional grounds. The Tribunal, therefore, directed the Appellate Assistant Commissioner to receive evidence on the question whether the lorries belonged to the assessee or to the joint family of himself and his sons and submit a finding. The Appellate Assistant Commissioner in his report gave a finding that the lorries belonged to the joint family of the assessee and his sons. The Tribunal was of the view that when the partnership was formed and the lorries were taken over by the partnership the lorries which were once the assets of the joint family became the assets of the partnership and since the ownership accordingly was transferred from the joint family to the different entity which is the partnership, Section 41(2) was attracted. The Tribunal did not agree with the assessee that the transfer to the partnership firm was as a going concern or amounted to a reorganisation of the business and held that since the lorries had been separately valued and the consideration for each item shown separately, the difference in the sale price and the written down value had to be treated as profit within the meaning of Section 41(2). In the result, the Tribunal dismissed the appeal.

4. At the instance of the assessee, the following three questions have been referred:

"1. Did the formation of the partnership between the assessee's sons as representing the joint family of the assessee and A. Kanniappan and the taking over of the business carried on by the partners, amount to a sale of the assets previously held by the family to the firm attracting Section 41(2) of the Act ?

2. Whether the transaction is a slump transaction and is not liable to be treated as a sale of assets ?

3. Whether, on the facts and in the circumstances of the case, the order passed by the Tribunal that the assessee is liable to be taxed u/s 41(2) of the Act on Rs.

45,185 or any part thereof is lawful ?"

5. The learned counsel for the assessee contended that when the partnership took over the lorries, there was no transfer from the joint family to the partnership or from an individual member of the joint family to the partnership. Since the partnership is not a legal entity and the members constituting the joint family were also members of the partnership with a third party, the lorries still continued to be owned by the joint family as such though the partnership also could be considered as an owner and that, therefore, Section 41(2) is not attracted. The learned counsel for the revenue, on the other hand, contended that a Hindu undivided family as such could not be a partner in a partnership concern. Therefore, even though all the members constituting the Hindu undivided family are the members of the partnership, the Hindu undivided family as such could not be treated as a partner in a partnership. The lorries which were once the properties of the Hindu undivided family had become the asset of the partnership in which the Hindu undivided family was not a partner and, therefore, it should be deemed that there was a sale from the Hindu undivided family to the partnership as such.

6. This court in Commissioner of Income Tax Vs. Janab N. Hyath Batcha Sahib, . had to consider the applicability of Section 10(2)(vii) of the Indian Income Tax Act, 1922, corresponding to Section 41(2) of the income tax Act, 1961, in a case where a proprietary concern was converted into a partnership concern. This court observed as follows :

"Barring the exceptional, cases of limited recognition of a firm of partnership as an entity, the normal position in law of a firm is that it is not a legal entity, unlike an incorporated company. A firm is but a convenient and compendious name given to a contractual relationship: in which two or more persons combine their efforts and conjointly apply the same to a commercial or business activity with a view to make profit. Section 4 of the Indian Partnership Act makes this explicit and says that a " 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. This relationship does not appear to cloud or destroy the identity of the partners whose rights and liabilities vis-a-vis each other are governed by the terms of the partnership and the provisions of the Indian Partnership Act. The members of a firm, from a certain point of view, therefore, remain as co-owners in a limited sense and subject to the terms of the contract of partnership and the principles of law governing such relationship. When, therefore, A makes over his property to a firm consisting of A and B, it will be a nice question--whether the transaction involves a transfer of the property. By such a transfer A clearly does not divest himself completely of his rights or interest in the property, though it is true B, by reason of the transaction, becomes entitled to certain rights which are regulated by the terms of the agreement of partnership, as well as the provisions of the Indian Partnership Act."

7. The Supreme Court also in Commissioner of Income Tax v. Dewas Cine

Corporation, [1960] 68 ITR 240 ., with reference to a partnership formed for the first time and one of the members of the partnership bringing into the firm assets held by him, held that there was no transfer and that the property became the property of the firm, not by any transfer, but by the very intention of the parties evinced in the agreement between them to treat such property belonging to one or more of the members of the partnership as that of the firm. In Tax Case No. 260 of 1969 (D D. Kanniah Pillai Vs. Commissioner of Income Tax, , we had occasion to deal with this question and following these decisions, we have also held that even though the Income Tax Act enables an assessment to be made in the name of a firm, it does not in terms make, it a legal entity with all its consequences and, therefore, there could not be a sale within the meaning of the Sale of Goods Act when one person converts his sole proprietary concern into a partnership of which he is a partner.

8. The learned counsel for the revenue, however, tried to distinguish these cases on the ground that they were all cases of individual persons converting their assets into a partnership property and not cases of properties of Hindu undivided families becoming the properties of a partnership. According to the learned counsel since the Hindu undivided family as such could not be a partner of a partnership firm, that principle could not be applied to such a case. In this case, it is not necessary to consider in general whether the property of a Hindu undivided family could become the property of a partnership firm without a transfer. In this case, the Hindu undivided family consisted of the father and two sons and all the three were partners in the new partnership along with a third party. Therefore, what was originally held by them as a Hindu undivided family is now held by them as partners in a partnership firm. In this respect there is no difference between an individual and a Hindu undivided family. As in the case of an individual, when he converts his individual property to that of a partnership, a Hindu undivided family also when the property of the Hindu undivided family becomes the property of the partnership ceases to hold the property. In the first case, the individual ceases to hold the property as his individual property and in the other case, the Hindu undivided family ceases to hold the property as Hindu undivided family property, but the members of the Hindu undivided family hold the property as partners. We are of the view that the ratio or the principle applicable to the case of a proprietary concern being converted into a partnership must also apply to the instant case. We, accordingly, hold that there was no transfer within the meaning of Section 41(2) of the Income Tax Act, 1961. We, accordingly, answer the first question in the negative and in favour of the assessee. In view of our answer to the first question, the other two questions do not arise for consideration. We, accordingly, give no answer to those two questions. The assessee will be entitled to his costs. Counsel's fee Rs. 250.