

(1979) 07 MAD CK 0033

In the Madras High Court

Case No : Tax Case No's. 533 of 1975 and 29 of 1976 (Reference No's. 375 of 1975 and 10 of 1976)

Commissioner of Gift-tax

APPELLANT

Vs

Ali Hussain M. Jeevaji and Another

RESPONDENT

Date of Decision : 18-07-1979

Acts Referred:

Citation : (1980) 123 ITR 421

Hon'ble Judges : Sethuraman, J; Balasubrahmanyam, J

Bench : Division Bench

Advocate : J. Jayaraman and Nalini Chidambaram, for the Appellant; T.V. Ramanathan, for the Respondent

Judgement

Sethuraman, J.—These two references arise out of a common transaction of the formation of a partnership on the following facts: There was a firm called N. A. Taiyabali and Company, carrying on business at No. 294, Linghi Chetty Street, Madras. The firm consisted of, (1) Goolamally Mohamadally, (2) Ali Hussain Mulla, (3) Hatimbhai Mulla, and (4) Fatam-bai Jeevaji. Each one of the partners had 1/4 share in the partnership firm. The firm had two branch offices, one at Devaraja Mudali Street and another at Sembudas Street. By a release deed dated 4th May, 1959, Fatambai Jeevaji took over the Devaraja Mudali Street branch, after relinquishing her rights and interest in the partnership firm. Similarly, Hatimbhai Mulla took over the branch office at Sembudas Street, after relinquishing all his rights and interest in the partnership firm Taiyabali and Company. After the retirement of these two partners, Goolamally Mohamadally and Ali Hussain Mulla were the two partners that were left to carry on the business at Linghi Chetty Street. Goolamally Mohamadally took his son as a partner in this firm and similarly, Ali Hussain Mulla also took his son into the firm. As a result of the reconstitution of the firm and the admission of the two new partners, the share of Goolamally Mohamadally came to be reduced to 1/4th and similarly the share of Ali Hussain Mulla came to be reduced to 1/4th. Before the advent of these two partners, they would have had one-half each in the

partnership business Taiyaballi and Company at Linghi Chetty Street.

2. Goolamally Mohamadally filed a return admitting a sum of Rs. 11,520 as the value of the gift in respect of the transfer of part of his share in the firm to his son. Similarly, Ali Hussain Mulla filed a gift-tax return showing a sum of Rs. 11,520 as the gift representing the value of the interest transferred to his son.

3. Later both of them disputed the liability to gift-tax, and contended that the reconstitution of the firm by admission of their respective sons into the partnership had not resulted in any gift to either of the two sons. The GTO negated this contention and computed the value at Rs. 62,940 by adopting three times the average profit for five years.

4. The two assessees filed appeals before the AAC which came to be simultaneously heard and disposed of. The AAC following a decision of this court in Commissioner of Gift-tax Vs. V.A.M. Ayya Nadar, , held that the right of a partner to share in the profits of a firm is as much property as the right of a partner to share in the assets of the firm, and that this right was capable of transfer at least as between the partners by common consent. Even the redistribution of the share by way of realignment of shares, had, according to him, the effect of diminishing the partner's interest and accordingly increasing the value of the share held by the new partner. Accordingly, the AAC held that the assignment of 50% of the respective assessee's shares in favour of his son amounted to a gift and is chargeable to gift-tax. The result was that the two appeals filed by the respective assessees failed.

5. The respective assessees filed appeals before the Tribunal and the appeal filed by Goolamally Mohamedally came to be heard and disposed of by an order dated December 31, 1971. The other appeal of Ali Hussain Mulla came to be heard subsequently and disposed of on January 16, 1975. In both the appeals, the contention of the assessee that as a result of the reconstitution of the firm there was no realignment of the shares involving transfer of 50% of the respective assessee's shares in favour of the son was not accepted. The Tribunal did not also accept the contention that there was no transfer, as in the view of the Tribunal, Section 2(xxiv) defining transfer of property was satisfied in the present case. However, the Tribunal came to the conclusion that there was no transfer without consideration and in doing so it referred to the decision of the Gujarat High Court in Commissioner of Gift Tax, Gujarat I Vs. Karnaji Lumbaji, and its finding with reference to the present case was as follows :

" In the present case when the partnership firm was reconstituted the appellant's son was taken as a working partner. Clause 4 of the partnership deed provides that the surplus of the share of profits after deducting the monthly drawings belong to the appellant's son and shall remain in the partnership until the amount accumulates to Rs. 20,000, and it should be treated as capital brought by the appellant's son. It, therefore, follows that the appellant's, son has contributed his share of the capital. As per the provisions in the partnership

deed, the appellant's son has to attend to the business of the partnership firm with a liability to share the future losses of the firm, if any. It is, therefore, clear that the admission of the appellant's son as a partner in the firm was not gratuitous. We, therefore, hold that even though there was a transfer by the appellant of his 50% share in the partnership firm to his son, the transfer was for consideration and there was no gift by the appellant to his son attracting the liability to gift-tax under the Act. "

6. In the order dated 16th January, 1975, the same conclusions were adopted. The result was that in both the cases, the levy of gift-tax with respect to the transactions under consideration was cancelled.

7. There is one aspect of the Tribunal's order which requires to be considered before we proceed further. In the abstract given above from para. 8 of the order of the Tribunal dated December 31, 1971, it is stated that the assessee's son has contributed his share of the capital. The partnership deed has been annexed as enclosure to the statement of the case. The deed is dated 5th day of May, 1959. In Clause 4 of the partnership deed, it is stated that the third and fourth partners, that is, the two sons of the respective partners, shall be the working partners and that the surplus of the share of profits after deducting the monthly drawing as provided in the deed at the end of each year belonged to the two working partners and should remain in the partnership until, by this means, it accumulated to Rs. 20,000 each. This sum should be treated to be the capital brought in by the two incoming partners. Clause 12 of the partnership deed provided that the two working partners could draw a sum of Rs. 100 on account of his share of profits for the current year. But if on taking the annual account as provided in the deed, the monthly sum drawn exceeded the share of profits due to them from the partnership, they should forthwith repay such sum to the firm. The two clauses, viz., clauses 4 and 12 taken together would only show that the contribution of the capital was to be in the future and not in the present, i.e., at the time of the formation of the firm. The Tribunal in so far as it stated that the respective sons of the two assessees had contributed their share of the capital at the relevant time is not borne out by the partnership deed. We may, therefore, proceed, to consider the cases on the basis that the contribution of capital was to be in the future out of the share of profits accruing to the account of the respective new partners and remaining in the account of the firm after the monthly drawings are made.

8. In Commissioner of Gift Tax, Gujarat I Vs. Karnaji Lumbaji, , the Gujarat High Court considered a case on the following facts : The assessee in that case and his four sons were doing business in partnership. The assessee had 4 annas share and his four sons had each a share of 3 annas. Two other sons were working as employees in the partnership firm. With effect from 1st November, 1959, the two sons, who were previously working as employees, were taken in as partners, and the shares of the assessee and one of his sons were reduced to 6 paise and 13 paise respectively and the two new partners were given each 12

paise share. The GTO held that on account of the reduction of the assessee's share from 25 paise to 6 paise, there was a gift of 19 paise share of the assessee in the goodwill of the firm to the two sons and that the assessee was liable to gift-tax. The Appellate Tribunal held that the assessee did not have any specific interest in the goodwill and that there was no existing movable or immovable property which could be transferred by the assessee to his two sons. It was also held that the admission of the two sons was not without consideration in money or money's worth. The Gujarat High Court, speaking through Bhagwati C. J., (as he then was) pointed out at p. 352 as follows:

" Now, obviously when the partners in an existing firm admit a new partner, they would do so for one of two reasons--either because he is going to bring finance or because he is going to attend to the business of the firm. Here in the present case, Mohanlal Karnaji and Govindlal Karnaji were paid employees of the firm and they were sufficiently experienced in the business of the firm. The result of admitting them as partners obviously was that the firm would be saved the remuneration which would otherwise be payable to them as employees. Moreover, as pointed out by the Tribunal, they had experience of running the business and, as partners, they would be able to attend to the business and give the benefit of their experience to the firm. It is therefore not possible to say that the admission of Mohanlal Karnaji and Govindlal Karnaji as partners in the firm was gratuitous without any consideration. The burden of proving that a particular transfer is a gift is upon the revenue and it is for revenue to show that the transfer is without consideration. There is no material brought here to show that Mohanlal Karnaji and Govindlal Karnaji were admitted as partners in the firm without consideration. On the contrary the facts clearly show that they were admitted as partners for consideration, the consideration being that with their experience gained by them as employees they would attend to the business of the firm, no remuneration would be payable to them as was being done till then, they would share not only in the assets but also in the liabilities of the firm and they would also participate in the future losses of the firm, if any. "

9. It was, therefore, held that even though there was a transfer of a 19 paise share in favour of Mohanlal Karnaji and Govindlal Karnaji, the transfer was not without consideration. The learned judges have specifically stated that they do not express any opinion on the question whether there was a transfer by the father of his 19 paise share in favour of his two sons.

10. This decision has been considered in Additional Commissioner of Gift-tax Vs. A.A. Annamalai Nadar, . In that case, the assessee who was carrying on a proprietary business converted it into a partnership by taking his major son who was working with him in the business for remuneration and admitted his two minor sons to the benefits of the partnership. The GTO held that to the extent of the interest of the three sons in the firm, there was a gift. The assessment was confirmed by the AAC. On further appeal, the Tribunal held that the transfer was for consideration. This court pointed out in the reference that in view of the

capital contribution by the three sons and rendering of services and agreement to share the losses by the major son, there was adequate consideration for the conversion of the proprietary business into a partnership business and hence there was no question of any gift of goodwill to the major son while, as far as the minor sons were concerned, there was no transfer of any assets as such to them so that there could be no gift of any goodwill in their favour.

11. Another case also raised a similar problem and that case is Commissioner Of Gift-Tax, Madras-II Vs. N. Palaniappa Mudaliar And Another, . Two persons were partners in a firm. This firm was reconstituted by taking the four sons of the one, and the brother and two sons of the other, as partners. The share of each of the two original partners was correspondingly reduced. The GTO considered that the reduction in the share in the hands of the original partners was liable to gift-tax. On appeal, the AAC did not agree with the GTO. He held that the admission of the two new partners was to effectively supervise and control the business of the firm which had a number of branches in various places and considering the expansion of the business, the introduction of the new partners could be said to be solely for the business. The department appealed to the Tribunal and the Tribunal held that there was no element of gift involved in the reduction of the original partners' share as a result of the admission of the other persons, as the transfer in each of the cases was for consideration in money or money's worth. In that case, there was a finding by the Tribunal that the new partners were taken in for purposes of expansion of business and for getting fresh financial resources, and, it was, therefore, held that the existence of consideration in money or money's worth had been established, and that there was no gift as defined in the Act.

12. The result of these decisions would show that it is possible to look into the partnership deed itself to find out as to what was the consideration that brought in the new partners into the firm. These cases also establish that the consideration need not flow into the hands of the persons whose share in the partnership gets reduced. The partnership itself is a specie of contract and the arrangement between the partners could always be looked into to find out as to what is the result of the transaction and whether there was gratuitous admission of the new partners. In the case in Additional Commissioner of Gift-tax Vs. A.A. Annamalai Nadar, , two minors were taken into the firm. They did not render any service to the firm. The minors had only contributed capital. The contribution of capital was taken to be consideration for the admission of the minors into the benefits of the partnership and it was, therefore, held that the transaction did not result in a gift from the father to the minor son. Thus, mere contribution of capital would be enough to take the case out of the category of gifts, unless the facts established it that the contribution of capital was illusory. Rendering of service by the incoming person has been taken to be consideration for admission of a partner in the decision of the Gujarat High Court in Commissioner of Gift Tax, Gujarat I Vs. Karnaji Lumbaji, and also of this court in Additional Commissioner of Gift-tax Vs. A.A. Annamalai Nadar, . The Gujarat High Court has

also referred to the facts that the two incoming partners subjecting themselves not only to share in the assets but also in the losses of the firm, would itself constitute consideration for the admission of the new partners into the firm. Judged in the light of these decisions it is clear that in the present case, there was consideration for the admission of the two sons of Goolamally Mohamadally and Ali Hussain, as both of them have rendered services. Such expectation of services would constitute consideration and so long as they fulfilled this expectation, their admission would not result in any liability to gift-tax.

13. The questions referred to us in the two cases are as follows:

T.C. No. 29/76:

" Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the assessee was not liable to pay gift-tax in respect of that part of his right to share in the profits of the firm as a partner which he had surrendered in favour of his son ?.. "

T.C. No. 533/75:

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the assessee was not liable to pay gift-tax in respect of that part of his right to share in the profits of the firm as a partner which he had surrendered in favour of his son ?"

14. In both these questions, there is an assumption that there was a surrender in favour of the particular son by the respective partners. But actually there is no such surrender. At the time, when the other two partners left the firm taking the two branches for themselves, the two remaining partners took their respective sons into the firm. Therefore, there is no question of surrender as such in favour of the particular son by the particular partner. We do not think it necessary to reframe the question to remove this error. The questions referred to us in each case in answered in the affirmative and in favour of the assessees. The respondent-assesseees will be entitled to their costs. Counsel's fee Rs. 250 in each.