

(1989) 03 KAR CK 0032
In the Karnataka High Court
Case No : Tax Reference Case No. 10 of 1983

Commissioner of Gift Tax

APPELLANT

Vs

C.S. Patil

RESPONDENT

Date of Decision : 08-03-1989

Acts Referred:

Gift Tax Act, 1958 — Section 26 (3)

Citation : (1989) 78 CTR 194 : (1989) 180 ITR 97 : (1989) 46 TAXMAN 199

Hon'ble Judges : S. Rajendra Babu, J;M. Rama Jois, J

Bench : Division Bench

Advocate : K. Srinivasan and H. Raghavendra Rao, for the Appellant; G. Sarangan, for the Respondent

Judgement

M. Rama Jois, J.—This is a reference u/s 26(3) of the Gift-tax Act, 1958. The question referred for the opinion of this court reads :

"Whether, on the facts and the circumstances of the case the Gift-tax Appellate Tribunal is right in law in holding that the assessee is not chargeable to gift-tax in respect of the reduction in his share interest on the admission of the new partners ?"

2. The facts of the case are these : The assessee was a partner in the firm, Shree Milk supply. During the accounting year relevant to the assessment year 1975-76, there was realignment of shares in the firm on the admission of new partners. Prior to April 1, 1974, there were four partners in the firm including the assessee. The share of profit each of them was 25 per cent. By a partnership deed dated April 14, 1974, a change in the constitution of the firm was brought about by admitting six more partners. The original four partners had the following credit balances to their capital account as on April 1, 1974.

Rs. C. S. Patel 12,000 C. B. Fatakia 70,000 P. N. Sharma 40,000 R. C. Patel 90,000 ----- Total 2,12,000 ----- 3. Under the partnership deed dated April 14, 1974, six new partners were admitted. While doing so, under the

agreement, C. S. Patel reduced his profit-sharing ratio from 25% to 15%. Out of the 10% of the share reduced, 5% went to Sita Patel and another 5% to Rajnikant P. Patel. Similarly, the share of C. B. Fatakia was reduced by 10% and it went to Yasmin K. Patel. Out of the reduction of share of 10% of P. N. Sharma, 5% went to Suresh Sharma and another 5% to Dinesh Sharma. The reduction of share of 10% of R. C. Patel went to Saroj V. Patel. The incoming six partners also brought in their capital. In the changed set up, the capital contribution and profit-sharing ratio of the ten partners was as below :

Sl. No.	Name	Capital contribution	Profit-sharing ratio
1.	C. S. Patel	12,000	15%
2.	C. B. Fatakia	70,000	15%
3.	P. N. Sharma	40,000	15%
4.	R. C. Patel	90,000	15%
5.	Sita Patel	15,000	5%
6.	Yasmin K. Patel	10,000	10%
7.	Dr. Suresh Sharma	10,000	5%
8.	Saroj V. Patel	10,000	10%
9.	Rajnikant P. Patel	10,000	5%
10.	Dinesh Sharma	12,000	5%

4. The Gift-tax Officer considered that the surrendering of 10% share of profit by the partners in favour of the incoming partners amounted to gift and accordingly he computed amount of gift and brought it to tax. The order of the Gift-tax Officer was taken in appeal before the Appellate Assistant Commissioner. The Appellate Assistant Commissioner confirmed the order of the Gift-tax Officer. He, however, gave some relief to the assessee in the matter of computation. The matter was taken in appeal by the Revenue before the Income Tax Appellate Tribunal. The Tribunal took the view that when new partners were admitted and the existing partners surrendered their share of profit in favour of the incoming partners, it would amount to a gift if the admission is without consideration; but in a case where the new partners introduced/contributed capital, it amounts to adequate consideration and, therefore, cannot be treated as gift. On the facts of this case, as admitted the six new partners, in whose favour the erstwhile four partners surrendered 10% of their right to share profit, had contributed capital, the view taken by the Gift-tax Officer and the Appellate Assistant Commissioner that there was a gift either in respect of surrendering of the part of the right to profit or in respect of goodwill was reversed by the Tribunal. It is thereafter at the instance of the Revenue and pursuant to the order made by this court in C.P. No. 230 of 1981, dated June 3, 1982, that the Tribunal has referred the question for our opinion.

5. Learned counsel for the Revenue, in support of his contention, relied on the judgment of the Supreme Court in Commissioner of Gift Tax, Gujarat Vs. Chhotalal Mohanlal, In the said case, on the reconstitution of the firm, the share of the assessee, Chhotalal Mohanlal, was reduced to 4 annas and for the remaining 4 annas, two minor sons of Chhotalal Mohanlal were admitted to the benefits of the firm, one of them having 12% and the other having 13%. In the said case, the Tribunal and, on a reference, the High Court held that there was no gift. On appeal, the Supreme Court reversed the decision of the High Court

and held that there was a gift within the meaning of section 2(xii) of the Gift-tax Act. The Supreme Court held that good will is property and when minor are admitted to the benefits of partnership in a firm and the share of an existing partner is reduced thereby, the right to the money value of the goodwill stands transferred and the transaction constitutes a "gift" under the Gift-tax Act. Learned counsel for the assessee submitted that the ratio of the said decision would have been applicable to this case if the incoming partners had not contributed any share capital and as a result there was no alteration in the share capital our attention in the name of the assessee. In particular, learned counsel invited our attention to the last sentence in the first paragraph of the judgment of the Supreme Court at page 126, which reads :

"No alteration was, however, made regarding the share capital standing in the name of the assessee."

6. Learned counsel also relied on a Division Bench decision of this court in D.C. Shah and Others Vs. Commissioner of Gift Tax, Karnataka, . In the said case also, a similar question arose for consideration. In the said case, this court held that when there was contribution of capital by the new partners, it would be sufficient and adequate consideration for being inducted as partners, and as a result, there was no taxable gift on account of reallocation of shares. Learned counsel also relied on the judgment of the Madras High Court in Additional Commissioner of Gift-tax Vs. A.A. Annamalai Nadar, in which the Madras High Court held that when there was capital contribution by the new partners inducted into a partnership firm in whose favour a specified percentage of profit was allocated, it did not amount to gift.

7. Learned counsel for the Revenue, however, submitted that the reconstitution of a firm not only involves transfer of interest in the property, namely the right to share future profits but also the right of goodwill and that the admission of a new partner on the basis of his capital contribution, his experience to contribute for the development of the firm as also the covenant to share liabilities and losses and to devote time and skill, might be adequate consideration so far as right to share future profits is concerned but not so in respect of goodwill, which is an asset of the firm, earned in the past before the induction of a new partner and, therefore the extent of transfer of an interest in goodwill amounts to gift. For this proposition, learned counsel again relied upon the decision of the Supreme Court in Commissioner of Gift Tax, Gujarat Vs. Chhotalal Mohanlal, . That case again, in our opinion, is distinguishable, for, that was a case where there was no reduction in the capital contribution of the original partners, whereas in the present case, the capital contribution had been altered as indicated earlier and there was entirely a new complexion so far as the contribution towards the capital is concerned. If there was contribution of capital from new partners, there can be no question of gift even in respect of goodwill because unless a business had goodwill, no person would like to join that business as a partner and contribute capital. It is indeed the goodwill of the firm itself which attracts new capital.

Therefore, the capital contributed by the new partners constitutes adequate consideration not only in respect of the right to share future profits but also in respect of the property in the goodwill.

8. In our opinion, the ratio of the decision in D.C. Shah and Others Vs. Commissioner of Gift Tax, Karnataka, is attracted to the facts of the case having regard to the undisputed fact that every one of the six partners admitted as partners to the firm had contributed shares capital. We also agree with the submission of learned counsel for the assessee that the decision of the Supreme Court in Commissioner of Gift Tax, Gujarat Vs. Chhotalal Mohanlal, would have applied, only if in this case, the new partners had not brought in or contributed any share capital.

9. In the result and for the reasons aforesaid, we answer the question referred for our opinion as under :

On the facts and in the circumstances of the case, the Gift-tax Appellate Tribunal is right in law in holding that the assessee is not chargeable to gift-tax in respect of the reduction in his share interest on the admission of the new partners.