

(1971) 08 KL CK 0014

In the High Court Of Kerala

Case No : Income Tax R. No. 15 of 1969

Commissioner of Gift Tax

APPELLANT

Vs

Ganapathy Moothan

RESPONDENT

Date of Decision : 12-08-1971

Acts Referred:

Gift Tax Act, 1958 — Section 2(xii), 2(xxiv), 2(xxiv)(b), 26(1), 4

Citation : (1971) KLJ 743

Hon'ble Judges : T.S. Krishnamoorthy Iyer, J; K.K. Mathew, J

Bench : Division Bench

Advocate : P.K. Krishnankutty Menon, for the Appellant; T.M.K. Nambiar and V. Sivaraman Nair, for the Respondent

Judgement

K.K. Mathew, J.—This is a reference at the instance of the Commissioner of Gift Tax, u/s 26(1) of the Gift Tax Act, 1958 (hereinafter referred to as the Act). The questions of law referred are: (1) whether on the facts and in the circumstances of the case there was a gift within the meaning of section 2 (xxiv) (b) and section 2 (xii) of the Gift Tax Act? (2) whether on the facts and in the circumstances of the case the transaction in question was exempt u/s 5(1)(xiv) of the Gift Tax Act? The assessee was carrying on the business in rice and paddy in the name and style of K. Ganapathi Moothan. He owned two rice mills and had also taken on lease another rice mill. On 14-4-1962 he converted this proprietary concern into a partnership taking his three major sons G. Kannan, G. Krishnankutty and G. Raghavan, as partners by a deed dated 14-4-1962. The capital of the partnership was Rs.90,000/-, of which the assessee contributed Rs.60,000/-; and the three sons Rs.10,000/- each. The assessee made a gift of Rs.20,000/- to two of his sons Krishnankutty and Raghavan; and it was this amount that was brought by them as capital in the partnership. In 1963-64 assessment year, the assessee showed Rs. 20,000/- as gift in filing the voluntary return. The Gift Tax Officer found that by taking the assessee's three sons as partners in the business the assessee has made a gift of a part of the good-will of the business to his sons and held that the assessee was liable to be taxed on

that gift also. The Gift Tax Officer valued the good-will on the basis of three years' purchase price of average 5 years' profits; and this amounted to Rs. 1,02,624/-; and three-fourth of this sum came to Rs.76,968/-. This amount was brought to tax along with the cash gift of Rs.20,000/-. The assessee filed an appeal before the Appellate Assistant Commissioner and contended that the conversion of the proprietary business into partnership did not involve a gift of the good-will to his three sons. The contention was not accepted by the Appellate Assistant Commissioner. He held that by the admission of the sons into the business, there was a reduction in the value of the property owned by the assessee in the form of goodwill to the extent of the share in the business given to the three sons. He therefore found that the transaction in admitting the sons into the partnership amounted to a gift as defined in section 2(xii) of the Act, read with section 2(xxiv) (b) and 2(xxiv) (d). The Appellate Assistant Commissioner also negated the contention of the assessee that the gift was exempt u/s 5(1) (xiv) since he found that in a case where a portion of the business itself was gifted it could not be said that the gift was made in the course of carrying on the business. However, he allowed a reduction in the valuation of the good-will, which was determined at Rs. 28,830/- as against Rs. 76,968/- as estimated by the Gift Tax Officer. Against this order the assessee filed an appeal to the Appellate Tribunal; and the Tribunal held that there was no gift in view of the fact that the recitals in the partnership deed would show that the transfer of the goodwill was for consideration. According to the Appellate Tribunal the agreement to share the losses by all the three partners; and the agreement to contribute skill, labour and experience constitutes consideration in money's worth. The Tribunal also held that the transaction would not fall within the definition of gift as contemplated in section 2(xii) of the Act. The Tribunal confirmed the finding as regards the valuation of the good-will made by the Appellate Assistant Commissioner. It also held that the gift was immune from tax by virtue of section 5(1) (xiv) of the Act.

2. The points for consideration in respect of the first question referred are whether the assessee had a good-will in respect of his business before he entered into the partnership; whether the good-will was transferred by converting the proprietary concern into it partnership and whether the transfer would amount to a gift within the meaning of section 2(xii) of the Act read with sections 2(xxiv) (b) or 2 (xxiv) Section 2(xii) is as follows:

Gift" means the transfer by one person to another of any existing movable or immovable property made voluntarily and without consideration in money or money's worth, and includes the transfer of any property deemed to be a gift u/s 4;

It is clear from the section that in order to constitute a gift there must be a transfer of property movable or immovable without consideration. Sections 2 (xxiv) (b) and 2 (xxiv) (d) defines what transfer of property means:

2(xxiv) "transfer of property" means any disposition, conveyance, assignment,

settlement, delivery, payment or other alienation of property and, without limiting the generality of the foregoing, includes;

(b) the grant or creation of any lease, mortgage, charge, easement, licence, power, partnership or interest in property;

(d) any transaction entered into by any person with intent thereby to diminish directly or indirectly the value of his own property and to increase the value of the property of any other person;

The assessee was carrying on the business in rice milling and paddy as also in grocery before he entered into the partnership. He had a good-will in respect of that business when he entered into the partnership. That good-will is not seen to have been transferred specifically by him to the partnership. But he could not have retained the good-will with himself after having taken his sons as partners in the business, because good-will was incidental to the business. The good-will was, therefore, transferred to the partnership. The good-will was property. Shah, J. said in *Rustom Cavasjee Cooper Vs. Union of India (UOI)*, :

Goodwill of a business is an intangible asset; it is the whole advantage of the reputation and connections formed with the customers together with the circumstances making the connection durable. It is that component of the total value of the undertaking which is attributable to the ability of the concern to earn profits over a course of years or in excess of normal amounts because of its reputation, location and other features; *Trego v. Hunt*. Good-will of an undertaking therefore is the value of the attraction to customers rising from the name, and reputation for skill, integrity, efficient business management, or efficient service.

Good-will by itself was property because it had a value of its own apart from the other assets of the firm. When the same business was carried on by the partnership, it had the advantage of the good-will which the assessee had before he entered into the partnership. Entering into partnership would constitute a transfer by virtue of the provisions of section 2 (xxiv) (b); in other words when the assessee entered into the partnership to carry on the same business there was a transfer of the good-will; and there is no reason to hold why the transfer did not amount to a gift. The Appellate Tribunal held that there was consideration for the transfer of the good-will in that the three partners contributed Rs. 10,000/- each; and therefore, the transfer would not amount to a gift. This is not correct. The contribution made by the partners was towards the capital of the partnership. The assessee specifically transferred the two rice mills in favour of the partnership by the partnership deed; and received consideration for the same from the partnership, put ploughed it back in the form of his contribution to the capital of the firm. But so far as the good-will is concerned it is not seen that the assessee received any consideration. It cannot be disputed that the good-will belonged to him before the formation of the partnership; and if by the partnership the good-will became the property of the firm, that can only be by

virtue of the transfer as contemplated by section 2(xxiv) and for that transfer there was no consideration proceeding from the partnership to the assessee. The assessee also became beneficially entitled to an interest in the good-will because the good-will became the partnership property. Therefore, it was that the Gift Tax Officer held that there was a gift only in respect of the three-fourth share in the good-will. As we have already said, the contribution of the partnership to the capital by the sons of the assessee was not as consideration for the transfer of the good-will, but for carrying on the business with a view to profit. Just like in any other partnership the contribution by the partners to the capital was for the purpose of working the partnership. As there was no consideration for the assessee in transferring the good-will to the firm by entering into partnership in respect of the property namely good-will which was an incident of the business formerly carried by him it amounted to a gift within the meaning of the term in section 2(xii).

3. The next question which remains for consideration is whether the assessee would get the benefit of section 5(1)(xiv). That section reads:

Gift tax shall not be charged under this Act in respect of gifts made by any person; (xiv) in the course of carrying on a business, profession or vocation, to the extent to which the gift is proved to the satisfaction of the Gift-tax officer to have been made bona fide for the purpose of such business, profession or vocation;

We had occasion to consider the scope of the section in ITR No.14 of 1969. In Commissioner of Gift Tax, Kerala Vs. George Kuruvilla, the Supreme Court observed;

We are unable to agree with the views so expressed. The donor is exempt u/s 5(1)(xiv) from liability to pay tax only if the gift is in the course of carrying on a business, profession or vocation and is made bona fide for the purpose of such business, profession or vocation. The clause does not enact that a gift made by a person carrying on any business is exempt from tax, nor does it provide that a gift is exempt from tax merely because the property is used for the purpose for which it was used by the donor. Without deciding whether the test of "commercial expediency" is strictly appropriate to the claim for exemption u/s 5(1) (xiv), we are of the view that there is no evidence on the record to prove that the gift to Thomas was "in the course of carrying on the business" of the donor, and "for the purpose of the business."

The recitals in the partnership deed do not make out that the gift was intended to be gift in the course of and for the purpose of business. The object of entering into partnership was to run the business on a more efficient basis by all the partners actively engaging in the conduct of the business. Though death or retirement of a partner would not dissolve the firm, any partner was at liberty to terminate the partnership by giving three months notice in writing. No evidence was adduced by the assessee to make out that the gift was made in the course

of and for the purpose of the business. We do not think that the fact that the partnership was formed to run the business on a more efficient basis by all the partners engaging in the business would be sufficient to uphold the claim of the assessee for exemption u/s 5(1)(xiv) of the Act. We therefore hold that section 5(1)(iv) has no application to the facts here.

4. The first question referred is answered in the affirmative and against the assessee; and the second question in the negative and against the assessee. A copy of this judgment will be sent to the Appellate Tribunal under the seal of the High Court and the signature of the Registrar.