

(1972) 02 MAD CK 0003

In the Madras High Court

Case No : Tax Case No"s. 268 of 1965 and 131 of 1967 (Reference No"s. 126 of 1965 and 44 of 1967)

Commissioner of Gift-tax

APPELLANT

Vs

M.K. Krishna Chettiar

RESPONDENT

Date of Decision : 03-02-1972

Acts Referred:

Gift Tax Act, 1958 — Section 2, 4
Partnership Act, 1932 — Section 14, 55

Citation : (1973) 87 ITR 1

Hon'ble Judges : V. Ramaswami, J;G. Ramanujam, J

Bench : Division Bench

Advocate : V. Balasubrahmanyam and J. Jayaraman, for the Appellant; T.V. Balakrishnan, C.V. Mahalingam and S. Mathrubutheswaran, for the Respondent

Judgement

Ramaswami, J.—These are references, at the instance of the Commissioner of Gift-tax, Madras, u/s 26(1) and (3) of the Gift-tax Act, 1958

(hereinafter referred to as "the Act"). The respondent-assessee was carrying on business in the manufacture of scented betel nut under the well-

known brand name "ASOKA". He converted the sole proprietary concern into a partnership firm under a partnership deed, dated April, 9,

1953, by taking his son, Kuppuraj Chetty, as his partner, under the name and style of "M. K. KRISHNA CHETTY". The partnership deed

provided that the partnership might be determined by either partner giving three months' notice in writing and on the expiration of such a notice, the

partnership shall determine. Clause 14 of the partnership deed further provided that, on dissolution of the partnership, the junior partner, namely,

Kuppuraj Chetty, the son of the assessee, shall be entitled to be paid the amount contributed by him as capital and his share of profits, if any, till

the date of dissolution after deducting all the amounts drawn by him and that the goodwill of the firm and all assets including trade marks, patent

rights, etc., and liabilities of the firm shall vest in the senior partner, namely, the assessee. The trade marks and patent rights, which had hitherto

been in the registered name of the assessee, were transferred in the name of the firm.

2. The assessee, on December 25, 1957, issued a notice for determining the partnership on March 26, 1958, and accordingly the firm was

dissolved under a deed of dissolution, dated March 26, 1958. This deed of dissolution provided for payment to the assessee by his son, the

surviving partner, of the amounts that stood to the credit of the assessee's capital account after adjustment of withdrawals as on that date and also

his share in the profits of the business for the period prior to March 26, 1958. The deed of dissolution further provided that the assessee "" shall

have henceforth no manner of right or interest in the business hitherto carried on by the firm of M/s. M. K. Krishna Chetty "". The assessee's son,

the other partner, undertook to discharge all the obligations and liabilities in respect of the said business and indemnified the assessee against all

claims or demands in respect of such obligations and liabilities. On the same day of dissolution, the surviving partner, namely, the son of the

assessee, entered into a partnership with his wife and two sons. On application to the Registrar of Trade Marks by the new firm, the trade mark

was transferred to the new firm.

3. The gift-tax assessment on the assessee for the assessment year 1958-59 was originally completed on November 20, 1958. Subsequently, on

being informed of the terms of the dissolution of the firm, in the view that the assessee retired from the business without obtaining any consideration

for the value of the goodwill of the business and that this amounted to a gift of the goodwill to his son, the assessing authority reopened the

assessment u/s 16 of the Act, and, after notice, by an order, dated November 30, 1961, held that the assessee's retirement from the partnership

business without obtaining any consideration for the value of the goodwill amounted to a taxable gift within the meaning of Section 2(xxiv)(d) and

Section 4(c) of the Act. Accordingly, he valued the goodwill at Rs. 6,00,000 on the basis of three years' purchase of the average of past five

years'' profits.

4. The assessee appealed unsuccessfully to the Appellate Assistant Commissioner. On a further appeal, the Appellate Tribunal held that there was no transfer of goodwill within the meaning of Section 2(xxiv)(d). The Tribunal also held that Section 4(c) of the Act did not apply on the ground that the abandonment by the assessee of his rights in the goodwill was bona fide and gave a finding that the subject-matter of the gift, if any, must be limited to only 10 annas share in the goodwill, equivalent to the assessee's profit sharing ratio in the partnership firm. On the question of valuation of the goodwill, disagreeing with the Appellate Assistant Commissioner, the Tribunal, in the view that the goodwill had to be valued at 18 months'' purchase of the super profit, determined the value of the goodwill at Rs. 2,00,000.

5. On the application by the Commissioner of Gift-tax, Madras, the following two questions were referred by the Tribunal :

(1) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that there was no gift or deemed gift

chargeable under the Gift-tax Act? and

(2) If the answer to question No. (1) is in the negative, whether the gift was only of a 10 annas share of the goodwill of the firm ?

6. In the application for reference, the Commissioner of Gift-tax, Madras, required the Tribunal to refer a question as to whether there was any

material for the Tribunal to hold that the value of the goodwill was Rs. 2,00,000 only in addition to the other two questions which have been

referred to by the Tribunal. Since the Tribunal refused to refer this question, he filed T.C.P. No. 17 of 1966 in this court, u/s 26(3) of the Act. In

compliance with the order, dated October 24, 1966, of this court made in T.C.P. No. 17 of 1966, the Tribunal has referred the following further

question for decision :

Whether, on the facts and in the circumstances of the case, there was any material for the Tribunal to hold that the value of the goodwill was Rs.

2,00,000 only ?

7. It was not in dispute that the business carried on by the assessee was a flourishing one and the trade mark of the partnership had acquired

considerable value and the business had gained goodwill. Goodwill is an

intangible asset and is a property which could be transferred also admits of no doubt. u/s 14 of the Partnership Act, subject to the contract between the partners, the goodwill of the business is the property of the firm. On dissolution, every partner is entitled to have the properties of the firm sold and the surplus, after payment of the debts and liabilities, distributed among the partners. Section 55 of the Partnership Act provides for sale of goodwill and the rights of partners in respect of the same. It is, therefore, clear that goodwill is a property which could be a subject-matter of gift under the Gift-tax Act.

8. The learned counsel for the revenue contended that a transfer of the goodwill by the assessee in favour of his son, the other partner, was

involved in the dissolution of the firm and that transfer, being for no consideration in money or money's worth, is a taxable gift. Clause 13 of the partnership deed provides that the partnership may be determined by either partner by giving to the other not less than three months' notice in writing and on the expiration of such notice the partnership shall determine. Clause 14 reads as follows:

On dissolution of the partnership, the junior partner shall be entitled to be paid the amount contributed by him as capital and his share of profits, if

any, till the date of dissolution after deducting all amounts drawn by him. The goodwill of the firm and all assets including trade marks, patent rights,

etc., and liabilities of the firm shall vest in the senior partner.

9. But the deed of dissolution provided that the senior partner shall cease to be a partner of the firm with effect from that date and the junior

partner shall pay the amount that stands to the credit of the senior partner's capital account and his share in the profits of the business up to that

date, after adjustment of the drawings. The deed further provided that the senior partner shall have "" no manner of right or interest in the business

hitherto carried on by the firm of M/s. Krishna Chetty "", and that the junior partner shall discharge the obligations and liabilities and indemnify the

senior partner against all claims or demands in respect of such obligations and liabilities.

10. It was contended by the learned counsel for the assessee that Clause 14 of the partnership deed vesting the goodwill of the firm in the assessee

on dissolution of the partnership will apply only in a case where the junior

partner retires from the firm and the senior partner continues the business. We are of opinion that there is no warrant for this contention in the language of Clause 14. It may be noted that the clause relating to goodwill forms a separate sentence, though it is in the same Clause 14. In our opinion, Clause 14 deals with dissolution as such and not merely a case of a dissolution when the junior partner retires. In either case of dissolution, the senior partner will be entitled to the goodwill and the trade marks and patent rights. But that right was given to the junior partner under the deed of dissolution. This is also clear from the fact that subsequent thereafter, on an application by the new firm of which the assessee's son was a partner, the Registrar of Trade Marks registered the trade marks in the name of the new firm. The question, therefore, for consideration is whether the dissolution, under which the son of the assessee became entitled to the goodwill, would amount to a gift within the meaning of Section 2(xii) read with Clause (xxiv) of the Act.

11. It is now settled that in order to attract the provisions of the Gift-tax Act, the transaction should involve a "" transfer"" from one person to another of an interest in property and an unilateral act is not a gift u/s 2(xii) and (xxiv) of the Act: vide the decisions in Goli Eswariah Vs.

Commissioner of Gift Tax, Andhra Pradesh, and The Commissioner of Gift Tax, Madras Vs. N.S. Getty Chettiar, .

12. The learned counsel for the assessee contended that, as in the case of unequal partition in a joint family, dissolution of partnership also does not involve any transfer of ownership from one person to the other. In this connection he relied on the decisions in Commissioner of Income Tax,

Madhya Pradesh Vs. Dewas Cine Corporation, , Commissioner of Income Tax Vs. Janab N. Hyath Batcha Sahib, , Velo Industries Vs.

Collector, Bhavnagar, , Sundaramjan v. Chelliappan, [1965] 2 M.L. J. 448 (Mad.), and Board of Revenue v. Murugesu Mudaliar, [1955] 2

M.L.J. 166.

13. In Commissioner of Income Tax v. Dewas Cine Corporation the Supreme Court held that the property, which is brought into partnership by

the partners when it is formed or which may be acquired in the course of the business, becomes the property of the partnership and a partner,

subject to any special agreement between the partners, is entitled upon

dissolution to a share in the money representing the value of the property and that the distribution of the surplus u/s 48 of the Partnership Act is for the purpose of adjustment of the rights of the partners in the assets of the partnership and it does not amount to a transfer of the assets. In *Commissioner of Income Tax v. Janab Hyath Batcha Sahib*, a Division Bench of this court held that, when a person hands over his property to a firm of partners consisting of himself and others, there is no transfer of property. These two decisions are under the Income Tax Act and the question for consideration was as to whether there was a sale coming u/s 10(2)(vii) of the Income Tax Act, 1922. It was held that since the expressions ""sale"" and ""sold"" are not defined in the Income Tax Act, those expressions used in Section 10(2)(vii) will have to be understood in their ordinary meaning and that according to its ordinary meaning ""sale"" is a transfer of property for a price and adjustment of rights of persons in a dissolved firm by allotment of its assets is not a transfer nor is it for a price. But the definition of transfer of property "" in Section 2(xxiv) of the Gift-tax Act is wider than the definition of ""sale"" under the Sale of Goods Act. These decisions therefore, are not of much assistance for determining the question now in issue.

14. In *Velo Industries v. Collector, Bhavnagar*, a Full Bench of the Gujarat High Court held that, when a partner retires from the partnership and the amount of his share in the partnership is given to him, the amount received by him is not a price for the sale of his interest in the partnership. This decision was also concerned with the question of ""sale"" under Article 25 of the Schedule I of the Bombay Stamp Act and is, therefore, not of much assistance.

15. In *Sundararajan v. Chelliappan* it was held that where, on a dissolution of a firm doing transport business, the buses and workmen are apportioned between the erstwhile partners, there was no transfer of ownership as such involved, a view similar to one taken by the Supreme Court in *Commissioner of Income Tax v. Dewas Cine Corporation* though rendered under the Industrial Disputes Act.

16. The decision very strongly relied on by the learned counsel for the assessee is the one in *Board of Revenue v. Murugesu Mudaliar*. The facts of that case are these : Five persons carried on a partnership business in the name of Gudiyatham Lungi Company. Three partners retired from the

partnership after executing a deed. This document recited that the releasers, after having retired from the firm, desired to renounce all interest in their partnership property receiving the proportionate value of their share in cash. The question for consideration was as to whether this document was a deed of dissolution of partnership falling under article 39(b) or release falling under Article 44(b) or a conveyance falling under Article 19 of Schedule I-A of the Stamp Act. The executants of the document agreed that it was a release falling under Article 44(b). The document was obviously not a deed of dissolution of partnership and, therefore, the only question that came up for consideration was as to whether the document would amount to a conveyance falling under Article 19. The Full Bench held that the document did not amount to a conveyance. While so holding the learned judges observed that there is no difference in principle between a document by which one co-owner renounced his claim for partition against the family property in consideration of certain income and the document by which one partner relinquished his interest in the partnership after receiving the proportionate value of his share. As seen from the facts set out, the partnership continued even after the retirement of the three partners and there was no dissolution of partnership. Further, having regard to the definition of "transfer of property" u/s 2(xxiv) of the Gift-tax Act, the ratio of this decision could not be applied to the instant case.

17. It may be seen that Section 2(xxiv)(b) of the Act defines "transfer of property" as including the grant or creation of partnership, though under the general law, there was no transfer where property is brought into the partnership by the partners when it is formed. Nor can the ratio of the decision in *The Commissioner of Gift Tax, Madras Vs. N.S. Getty Chettiar*, be applied to the instant case. In the case of a coparcenary all the coparceners are joint owners of the properties of the family. A coparcener has no definite share in the family property before its division. A partition is a process by which a joint enjoyment is transferred into an enjoyment in severalty. It is in those circumstances the Supreme Court held that a partition of a Hindu joint family did not effect any transfer of property as generally understood in law. Though partners own the entire partnership assets as co-owners, they have definite shares in the property. The definition of "transfer of property" in Section 2(xxiv) includes a

disposition ""'. The Supreme Court held that the word "" disposition "" in the context means "" giving away or giving up by a person of something which was his own ""'.

18. In the present case, under the partnership deed, on dissolution of the firm, the assessee becomes the owner of the goodwill. That ownership of the goodwill he gave up in favour of his son under the deed of dissolution. It is not contended that any consideration was received by the assessee for the transfer of the goodwill. We have, therefore, no doubt that there was a gift of the goodwill by the assessee to his son. In any case, we are of the view that the transaction will fall u/s 2(xxiv)(d) of the Act, as a transaction entered into by the assessee with intent thereby to diminish the value of his share in the partnership and increase the value of the share of his son in the partnership amounts to a transfer.

19. Alternatively, the learned counsel for the revenue contended that, as the partnership could be dissolved by issuing a three months' notice, when the assessee issued the notice on December 25, 1957, for determining the partnership on March 26, 1958, there was a dissolution of the firm on March 26, 1958, that consequently the goodwill came to be vested in the assessee and that on such vesting the assessee became the owner and when that was conveyed under the deed of dissolution there was a transfer of that property. We are unable to agree with this contention. As seen from the deed of dissolution, the deed was executed on March 26, 1958, and clause 3 mentioned that the firm stood dissolved on that day. The execution of the document and the dissolution were, therefore, simultaneous and there was no vesting of the goodwill in the assessee independent of and before the deed of dissolution was executed. On the facts of this case, we are not persuaded to hold that there was any vesting of the goodwill in the assessee prior to the execution of the deed of dissolution.

20. In view of what is stated above, no question of "" deemed gift "" u/s 4(c) of the Act could arise in this case.

21. That leads us to the second question, namely, whether the gift was only of a ten annas share of the goodwill of the firm. According to learned counsel for the revenue, the subject-matter of the gift was the value of the entire goodwill and the business. Per contra, the learned counsel for the assessee contended that only a 10 annas share in the goodwill, equivalent to the

assessee's profit sharing ratio in the partnership that was vested in the assessee on dissolution, alone could have been transferred by him to his son. This contention of the learned counsel for the assessee is based on the interpretation given by him to Clause 14 of the partnership deed. He contended that Clause 14 was intended to be applicable only when the junior partner of the firm, namely, the assessee's son, retired from the partnership and it was not meant to be applicable when the senior partner retired from the partnership. He further contended that the intention of the parties was to vest the goodwill in the surviving partner, whoever was the surviving partner. We are unable to agree with the contention of the learned counsel for the assessee. We have no doubt that Clause 14 is a clause relating to the dissolution and it could not be restricted to a case where a junior partner of the firm retired. There is no question of junior or senior partner retiring in the case of a dissolution of a partnership consisting of only two partners. Clause 14, in our opinion, provides for the vesting of the goodwill in the assessee on dissolution of the firm, whether the business was continued by the junior partner or the senior partner and that the assessee who is entitled to the entire goodwill transferred the same to his son on dissolution of the partnership.

22. The only other question that remains to be considered is the one that was referred to us in T.C. No. 131/67. The Tribunal valued the goodwill on the basis of 18 months' purchase of the average super profit. In determining this method of valuation, the Tribunal took into account that the assessee's son having been associated with the assessee for some years had come to know of the secret formula and that, therefore, the assessee was in a weak position to bargain for higher amount if the goodwill is to be sold. The Tribunal also considered that the expenses of management have to be deducted, but rejected the contention of the assessee that provision for taxes should also be taken into account before arriving at the super profits. The assessee filed statements before the Tribunal showing the average capital employed and the average borrowals for about six years along with the statements of average yearly profit and average capital employed. The Tribunal deducted the expenses of management and the normal return on capital from the average profit and determined the super profit at Rs. 1,27,814. The Tribunal also considered that having regard

to the reputation of the business of the assessee, 18 months" purchase of the average value, ""which is normally adopted for professionals, is low for a manufacturing business like that of the assessee, but having regard to the fact that his son knew that secret formula, 18 months" purchase was a fair value. Rounding up the figure thus arrived at, the Tribunal fixed the value of the goodwill at Rs. 2,00,000. We are unable to state that there was no material for the Tribunal to hold that the value of the goodwill was only Rs. 2,00,000.

23. For the foregoing reasons, we answer the first question in T.C. No. 268 of 1965 in favour of the revenue and hold that there was a gift of the goodwill chargeable under the Gift-tax Act. Our answer to the second question is that the gift was of the entirety of the goodwill and not the 10 annas share of the goodwill of the firm. But we answer the question in TX. No. 131 of 1967 against the revenue.

24. The applicant will be entitled to his costs in T. C. No. 268 of 1965, counsel's fee Rs. 250. The assessee will be entitled to his costs in T.C.

No. 131/67, counsel's fee Rs. 250.