
(1995) 03 KL CK 0026

In the High Court Of Kerala

Case No : Income-tax Reference No. 226 of 1985

COMMISSIONER OF GIFT-TAX

APPELLANT

Vs

SMT. C. K. NIRMALA.

RESPONDENT

Date of Decision : 06-03-1995

Acts Referred:

Contract Act, 1872 — Section 2
Partnership Act, 1932 — Section 14

Citation : (1995) 215 ITR 156

Hon'ble Judges : P. A. Mohammed, J

Bench : Division Bench

Judgement

P. A. MOHAMMED J. - This is a reference u/s 26(1) of the Gift-tax Act, 1958, at the instance of the Commissioner of Gift-tax, Trivandrum. The question of law referred by the Income Tax Appellate Tribunal, Cochin Bench, to this court for decision is extracted below :

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in finding that the transfer in question has not resulted in any gift assessable to gift-tax in the view that the capital brought in by the incoming partners can be taken as consideration for the transfer of 65 per cent. of the assessee's interest in the business ?"

The facts which are necessary for deciding the reference are summarised thus : The assessee was the proprietress of a trading concern known as "Gunbow Trading Company" doing business in coir products. In the year 1979, the said establishment was transformed into a partnership firm, the assessee continuing as one of the partners. The other partners are her two major daughters and her husband in his capacity as a trustee of a trust called "Krishnadev Trust". Three minor daughters of the assessee and two minor children of two married daughters are the beneficiaries of the trust. A partnership deed was executed wherein the share of each partner was specified. The assessee has 35 per cent. share and the two major daughters 15 per cent. each and the remaining 35 per

cent. goes to the trust. The three incoming partners had invested Rs. 10,000 each and the said amount was treated as their respective share of capital in the partnership business in view of the terms of the deed. The Gift-tax Officer, however, completed the assessment for the year 1980-81 u/s 15(3) of the Act fixing the goodwill of the proprietary business at Rs. 28,754. The officer further found that the assessee had gifted 65 per cent. of her right to share profits to the incoming partners. The contention of the assessee that transfer of interest was supported by consideration was rejected. Finally, the officer has passed an assessment order dated December 31, 1980 (annexure "A"), fixing the value of the taxable gift at Rs. 58,750. As against the said order passed by the Gift-tax Officer, the assessee filed an appeal which was rejected by the Appellate Assistant Commissioner as per his order dated January 2, 1982 (annexure "B"). The assessee filed a further appeal before the Income Tax Appellate Tribunal. The Tribunal agreed with the contention of the assessee that the transfer in question has not resulted in any gift assessable to tax and accordingly passed an order allowing the appeal on October 31, 1983 (annexure "C"). As against the said order, the Revenue has filed an application u/s 26(1) of the Gift-tax Act requiring the Tribunal to state a case to this court. Accordingly, the Tribunal referred the question stated above for the decision of this court.

When this reference came up before a Division Bench of this court, it was pointed out that there are two conflicting Division Bench decisions on the question to be answered by this court in the present proceeding. Those decisions are : (1) Commissioner of Gift-tax Vs. Ganapathy Moothan, and (2) Commissioner of Gift-tax Vs. K.A. Abdul Razack and Others, . That is how this case came up for decision before this larger Bench.

The question referred to this court for decision basically rests on the finding of the Tribunal, which is extracted below :

"We, however, agree with the assessee that transfer in question has not resulted in any gift assessable to gift-tax. The Gift-tax Officer has evaluated the Interest surrendered by the assessee in the business in favour of the incoming partners at the figure of Rs. 28,754. The recital in the partnership deed in clause 5(b) clearly shows that the incoming partners had brought in Rs. 30,000 as capital. This would be consideration for the assessee transferring 65 per cent. of her interest in her proprietary business. The consideration at the figure of Rs. 30,000 is more than the value of the interest as worked out by the Gift-tax Officer. u/s 4(1)(a) of the Gift-tax Act, the deemed gift is the amount by which the market valued of the property on the date of the transfer exceeds the value of the consideration. In view of this, there is no gift exigible to gift-tax."

Within the framework of the above finding what is required to be decided by this court is whether the transfer of property involved in this case would come within the meaning of the word "gift" in section 2(xii) of the Act. One of the essential ingredients constituting the gift under this provision is that the transfer of property by one person to another must be "without consideration in money or

moneys worth". However, the word "consideration" is not defined in the Act and, therefore, it must carry the meaning assigned to it in section 2(d) of the India Contract Act, 1872. In Keshub Mahindra and Others Vs. Commissioner of Gift Tax, Bombay City I, , the Bombay High Court, in a similar situation, adopted the said course.

Section 2(d) of the Indian Contract Act is thus :

"When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise."

The above provision is no doubt subject to such qualifications or limitations as contained in the Gift-tax Act. Under the Contract Act, the adequacy or inadequacy of the consideration is immaterial but under the Gift-tax Act an agreement to transfer property "otherwise than for adequate consideration" gives rise to a gift to the extent of the inadequacy. This court is not concerned with the adequacy or inadequacy of the consideration, for, the Tribunal has specifically found that the consideration in this case is more than the value of the interest transferred by the assessee to the incoming partners. No doubt, such transfer of interest includes the goodwill of the business. Therefore, the predominant question before this court is whether the capital introduced by the incoming partners can be taken as consideration for the transfer of the assessee's interest in the business.

There is nothing to show in the definition of the term "consideration" that the benefit of any act or abstinence must "directly" go to the promisor. A contract can arise even though the promisee does or abstains from doing something for the benefit of a third party and the promisor can treat the benefit to a partnership firm where he is also a partner as consideration. Sir William R. Anson said : "The consideration may be of benefit to the promisor, or to a third party, or may be of no apparent benefit to anybody, but merely a detriment to the promisee." (Principles of the English Law of Contract). In this case, the incoming partners have generated Rs. 30,000 as capital invested in the partnership business and this is more than the value of the interest transferred by the assessee in favour of the incoming partner. Here, the amount of Rs. 30,000 is the consideration for transferring the interest of the assessee and this consideration has not been directly paid to the promisor, but it is introduced as capital to the partnership. Therefore, it cannot be said that the transfer of interest by the assessee in favour of the incoming partners has not been supported by consideration. Once the transfer of interest is supported by consideration the essential ingredients constituting the gift obliterate. The different consideration may arise if the transfer of interest does not include the goodwill of the business. As far as this case is concerned the question of such consideration did not arise inasmuch as the goodwill is treated to be the interest transferred. Therefore, it can be safely concluded that there is no gift assessable

to tax in the facts of the present case.

On behalf of the Revenue, it was argued that the contribution towards capital by the incoming partners will not amount to consideration. In order to augment this point, the following observation of Lord Lindley as quoted in Lindley on the Law of Partnership (Sixteenth Edition) is brought to the notice of this court :

"By the capital of a partnership is meant the aggregate of the sums contributed by its members for the purpose of commencing or carrying on the partnership business, and intended to be risked by them in that business. The capital of a partnership is not, therefore, the same as its property."

This court has absolutely no disagreement with the above position of law governing the partnership business and its capital. But the cardinal issue in this case has to be solved within the framework of the provisions contained in section 2(xii) of the Gift-tax Act read with section 2(d) of the Indian Contract Act. The incoming partners had made available a sum of Rs. 30,000 for the transfer of the interest of the assessee as desired by her. This is not a voluntary action of the incoming partners, but an action in terms of the partnership deed giving in the transfer. No doubt this is a benefit to the promisor and so this is a consideration for the promise and at her desire or request, this may be adjusted towards capital or invested in the partnership business in any manner as the promisor likes. It is an action of the promisee on the desire of the promisor which constitutes consideration. The manner of its utilisation or enjoyment is dependent on the terms of the contract or agreement between the parties to the transaction.

Counsel for the Revenue relies on their decision in Commissioner of Gift-tax Vs. Ganapathy Moothan, . in support of his contention that there has been a transfer of property by the assessee in favour of the incoming partners. That was a case where the assessee was carrying on business in rice and paddy as sole proprietor. He converted his business into a partnership taking his three major sons as partners. The assessee had made a fit of Rs. 20,000 to two of his sons and this amount had been introduced by them as capital in the partnership. The Tribunal upheld the claim of the assessee that the fit was not exigible to tax. This court while answering the reference came to the conclusion that this is a gift in respect of the goodwill u/s 2(xii) and hence it is not exempt u/s 5(1)(xiv) of the Gift-tax Act as it then stood. The assessee had goodwill in respect of his business in rice and paddy when he entered into the partnership. "That goodwill is not seen to have been transferred specifically by him to the partnership. But he could not have retained the goodwill with himself after having taken his sons as partners in the business, because the goodwill was incidental to the business." Thus in substance this is a case where the goodwill had not been specifically transferred by the assessee to the incoming partners. But, in the present case, there is no case for the Revenue that the goodwill has not been transferred to the partnership. In fact what has been transferred as the assessee's interest represents the goodwill of the firm. The Tribunal found that the assessee had

transferred 65 per cent. of her interest in her proprietary business in favour of the incoming partners. In view of this finding, the question whether the interest of the assessee in her proprietary business, as determined by the Gift-tax Officer, would include the goodwill is not a relevant point to be considered in the present proceeding. The question referred in this case does not call for such an enquiry at all. That being so, the principle laid down in Commissioner of Gift-tax Vs. Ganapathy Moothan, have no decisive effect in the present case.

The law applicable in the present set of facts appears to have been correctly laid down by this court in CGT v. K. A. Abdul Razack [1972] 196 ITR 578. There it has been held that the capital contributed by the minors should be treated as consideration for the fit of interest surrendered in favour of the minors in determining the value of the taxable gift. That was a case where the assessee, a partner of a firm, had gifted Rs. 2,500 each to his four minor sons and there was a reconstitution of the firm whereby two new partners and the four minor sons of the assessee were also admitted. The assessee was entitled to 25 per cent. of the partnership before the reconstitution of the firm and it was reduced to 5 per cent. thereafter. Thus the assessee had transferred 20 per cent. of his share in the firm. The Gift-tax Officer worked out the goodwill of the firm at Rs. 2,13,972 and 20 per cent. of the same, namely, Rs. 42,794, was treated as the proportionate value of the goodwill surrendered by the assessee in favour of his four minor sons. Thus, this is a case where the goodwill has been transferred in favour of the incoming partners of the reconstituted firm. The Gift-tax Officer considered the fact that the assessee had surrendered 20 per cent. of his share in the firms and found that such surrender amounted to a gift taxable under the Gift-tax Act. In appeal, the Tribunal did not accept the assessee's contention that the contribution of Rs. 10,000 towards capital made by the four minor sons would amount to adequate consideration for the purpose of gift-tax, but at the same time the Tribunal found that it was to be treated as consideration for the transfer and that this amount should be adjusted against the value of the property transferred on the admission of the minors to the benefits of the partnership. The finding of the Tribunal was upheld by this court in the tax reference case.

On an anxious consideration of the question, this court does not find any apparent conflict of views between the Division Bench decisions of this court in Commissioner of Gift-tax Vs. Ganapathy Moothan, and Commissioner of Gift-tax Vs. K.A. Abdul Razack and Others, . As noticed earlier, the former is the case where the goodwill has not been transferred whereas the later is the one where the goodwill has been transferred. Therefore, the views expressed or the principles laid down in those cases are justified in view of the different factual situations arising in the cases.

An argument has been advanced by counsel for the assessee that the decision of this court in Commissioner of Gift-tax Vs. Ganapathy Moothan, is not good law in view of the decision of the Supreme Court in Commissioner of Gift-Tax, Kerala

Vs. P. Gheevarghese, Travancore Timbers and Products, . This court cannot agree with this submission. The Supreme Court in the said case observed (at page 409) :

"All that the Departmental authorities did and that position continued throughout was that they picked up one of the assets of the assessee's proprietary business, namely, its goodwill, and regarded that as the subject of gift having been made to the daughters who were the other partners of the firm which came into existence by virtue of the deed of partnership. This approach is wholly incomprehensible and no attempt has been made before us to justify it."

What the Supreme Court deprecated was the practice of the authorities in picking up only one of the assets of the firm, namely, goodwill, and regarding it as the subject-matter of the gift. According to the deed of partnership. Goodwill was part of the properties and assets of the business which the assessee had transferred to the partnership. But the Departmental authorities had never treated all those assets and properties of the assessee as the subject of gift. The Supreme Court did not say that the transfer of the goodwill as such is not liable to tax. It only said that the practice of picking up of goodwill alone cannot be justified. In the facts of that case, the court, however, held that no gift-tax was payable on the goodwill of the assessee's business.

In Khushal Khemgar Shah and Others Vs. Khorshed Banu Dadiba Boatwalla and Another, the Supreme Court held that the goodwill of a firm is an asset, So also in *Rustom Cavasjee Cooper Vs. Union of India (UOI)*, , it said : "Goodwill of a business is an intangible asset". In *Commissioner of Gift Tax, Gujarat Vs. Chhotalal Mohanlal*, , again it held : "Once goodwill is taken to be property and with the admission of the two minors to the benefits of partnership in respect of a fixed share, the right to the money value of the goodwill stands transferred, the transaction does constitute a gift under the Act." What this court in *Commissioner of Gift-tax Vs. Ganapathy Moothan*, said was nothing other than what the Supreme Court said in the aforesaid cases. "Goodwill by itself was property because it had a value of its own apart from the other assets of the firm", so said in *Commissioner of Gift-tax Vs. Ganapathy Moothan*, by this court. In this context it is very relevant to refer to section 14 of the Partnership Act which is reproduced hereunder :

"Subject to contract between the partners, the property of the firm includes all property and rights and interest in property originally brought into the stock of the firm or acquired, by purchase or otherwise by or for the firm, or for the purpose and in the course of the business of the firm, and includes also the goodwill of the business.

Unless the contrary intention appears, property and rights and interest in property acquired with money belonging to the firm are deemed to have been acquired for the firm."

The above definition indicates that the property of the firm includes the goodwill

of the business also. But, the question as to what are the properties of the firm in a particular case has to be decided with reference to the terms of the contract between the parties. Therefore, the exigibility of gift-tax in a given case is largely dependent on the provisions of the terms of the partnership deed or the terms of the contract governing the transactions between the parties. Broadly speaking, what this court has seen in the cases decided by this court as well as the Supreme Court, is that the terms of the contract or agreement between the parties are the determinative factors while considering the exigibility of transfer of rights of the assessee in favour of the incoming partners as gifts assessable to tax under the Gift-tax Act.

In view of the discussion hereinabove, we answer the above question referred to this court in the affirmative and in favour of the assessee.

A copy of this judgment under the seal of the High Court and the signature of the Registrar shall be forwarded to the Income Tax Appellate Tribunal, Cochin Bench.