

(1976) 07 MAD CK 0018

In the Madras High Court

Case No : Tax Case No. 16 of 1971 (Reference No. 15 of 1971)

Commissioner of Gift-tax

APPELLANT

Vs

T.S. Shanmugham, (by LR.)

RESPONDENT

Date of Decision : 27-07-1976

Acts Referred:

Gift Tax Act, 1958 — Section 5(1)

Citation : (1977) 110 ITR 237

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

Bench : Division Bench

Advocate : J. Jayaraman and Nalini Chidambaram, for the Appellant; S.V. Subramaniam, for Subbaraya Ayyar and Padmanabhan, for the Respondent

Judgement

Ismail, J.—The Income Tax Appellate Tribunal, Madras Bench, has referred the following two questions of law for the opinion of this court

tinder Section 26(1) of the Gift-tax Act :

1. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that there was no taxable gift for

1965-66 assessment ?

2. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the gift was exempt u/s 5(1)(xiv) of

the Gift-tax Act ?

The assessee was the owner of a business carried on under the name and style of M/s. Norton & Company. In the course of the business he was

assisted by his first son and subsequently he took the first son as a partner along with him. Later, his second son also assisted him in the business

and subsequently he too was taken into the partnership. By a partnership deed dated January 1, 1962, the share of profits of the three partners

was determined as 40 : 35 : 25. This firm was reconstituted under another partnership deed dated January 1, 1964, by which the first partner instead of taking 40% in the share of profits took only 25%, and the remaining 15% share of the profits was adjusted by increasing the shares of the other two partners from 35% to 40% and 25% to 35% respectively. The Gift-tax Officer took the view that the reduction of the first partner's, i.e., the assessee's share of profit from 40 to 25% and the consequential increase in the shares of the other two partners will constitute a "gift liable to be taxed under the provisions of the Gift-tax Act to the extent of the said 15% of the profits and accordingly levied tax. An appeal filed by the assessee also failed.

2. However, on second appeal preferred by the assessee to the Income Tax Appellate Tribunal, the Tribunal allowed the appeal and held, following its earlier decisions that when a partnership firm is reconstituted resulting in the reduction of share of profits of the partners, the consequent enhancement in the share of profits of the other partners could not result in a gift exigible to tax under the Gift-tax Act. Independent of the above conclusion, the Tribunal also held that the gift in question would fall within the scope of Section 5(1)(xiv) of the Gift-tax Act, and, therefore, would not be liable to tax. For the purpose of coming to this conclusion, the Tribunal referred to the recitals in the partnership deed dated January 1, 1964, as to why the first partner was reducing his share of profits and consequently increasing the shares of other partners and the Tribunal also held that the said redistribution was bona fide and it was not suggested by the department that it was brought about for any mala fide purpose and consequently the gift was made during the course of the carrying on of the business and was made bona fide for the purpose of carrying on the business and, therefore, will fall within the scope of Section 5(1)(xiv) of the Gift-tax Act. It is the correctness of these conclusions of the Tribunal that are challenged before this court in the form of the two questions extracted above.

3. As far as the first question is concerned, as we have pointed out already, the Tribunal merely followed the view which it had already taken in other cases, namely, that when a partnership firm is reconstituted resulting in the reduction of share of profits of some of the partners, the

consequent enhancement in the share of profits of the other partners could not result in a gift exigible to tax under the Gift-tax Act. The first

question extracted above covers this conclusion of the Tribunal. The earlier order of the Tribunal has come up to this court and this court has held

that the Tribunal was in error in taking that view. In Commissioner of Gift-tax Vs. V.A.M. Ayya Nadar, this court held that :

.....a right of a partner to share in the profits is as much property as a right of a partner to share in the assets of the firm. It is the right of a

partner which entitles him to a share in the profits of the firm and that, as we think, is a valuable right and capable of transfer at least as between the

partners by common consent. When so much is clear, we encounter no difficulty in approving the next step that when there is distribution of a

quantum of the share of profit as between its original holder and certain others who are all partners, it involves a transfer of the right which has the

effect of diminishing the assessee's interest and correspondingly increasing the value or quantum of the shares earlier held by the other two

partners. On that view, we think that the distribution by way of realignment of the one-third share of the assessee did involve transfer of property

amounting to a gift chargeable to tax.

The same is the view taken by this court in the two subsequent decisions in Commissioner of Gift-tax Vs. A.M. Abdul Rahman Rowther, and the

other in Commissioner of Gift-tax Vs. K.P.S.V. Duraiswamy Nadar (Decd.) (By Legal Representative), . In view of these decisions of this court,

it must be held that the Tribunal was wrong in stating as a general proposition that when a partnership firm is reconstituted resulting in the reduction

of share of profits of some of the partners, the consequent enhancement in the share of profits of the other partners could not result in a gift exigible

to tax under the Gift-tax Act. In view of this, we answer the first question in the negative and against the assessee.

4. That leaves the second question which is an independent question. Section 5(1)(xiv) of the Gift-tax Act so far as is relevant is as follows :

(1) 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.

For the purpose of bringing a "gift" within the scope of this section, the following requirements are necessary : (1) it must be a gift made by a

person in the course of carrying on a business, profession or vocation, and (2) the Gift-tax Officer must be satisfied that the said gift has been made

bona fide for the purpose of such business, profession or vocation. If these two tests are satisfied, the gift concerned will fall within the scope of

Section 5(1)(xiv) and, therefore, shall not be charged under the Act.

5. The learned counsel for the department drew our attention to the decision of the Supreme Court in *Commissioner of Gift Tax, Kerala Vs.*

George Kuruvilla, . In that case, the Supreme Court pointed out that there is nothing in the deed of gift which even remotely suggested that the gift

was made by the respondent in the course of his profession and bona fide for the purpose of carrying on his profession as practitioner in medicine.

In view of this, the Supreme Court held that there was 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". As a matter of fact, the recitals in the gift deed, which was the subject-matter

of consideration by the Supreme Court, were clear and it was recited in the deed that the gift was made "out of love and affection". Therefore, on

the facts of that case, the Supreme Court came to the conclusion that the gift in that case was not made for the purpose of profession and was not

made in the course of carrying on the profession. Consequently, we are of the opinion that the said decision is not of any assistance to the

department in the present case.

6. The next decision on which reliance was placed is again another decision of the Supreme Court in *Commissioner of Gift-Tax, Kerala Vs. P.*

Gheevarghese, Travancore Timbers and Products, . That decision followed the earlier decision of the Supreme Court referred to above and

merely sought to elucidate the two requisites involved in Section 5(1)(xiv), namely, the gift must be in the course of carrying on the business and it

must be made for the purpose of the business. In that context, the Supreme Court observed that the expression "in the course of the carrying on of

business, etc.," means that the gift should have some relationship with the

carrying on of the business. Similarly, the Supreme Court pointed out that the object in making the gift or the design or intention behind it should be related to the business. Having so observed, on the facts of that case, the Supreme Court held that the requirements of Section 5(1)(xiv) were not satisfied. The Supreme Court pointed out (page 412) :

The real intention of the assessee apparently was to take his daughters into the firm with the object of conferring benefit on them for the natural reason that the father wanted to look to the advancement of his daughters. It was further provided in the deed that even the minor children would, in due course, be admitted to the partnership.

7. In view of these facts, it was held that the gift with which the Supreme Court was concerned did not fall within the scope of Section 5(1)(xiv) of the Gift-tax Act.

8. As far as the present case is concerned, as we have pointed out already, the Tribunal has recorded the finding that the gift was made in the

course of carrying on the business and, secondly, it was made bona fide for the purpose of the business. Unless it is established that this conclusion

of the Tribunal is not supported by evidence, the finding of the Tribunal has to stand. In this case, far from there being no evidence, the evidence

available fully supports the conclusion of the Tribunal. As we have pointed out already, originally the business belonged to the first partner--the

assessee--and he was assisted in the carrying on of the business by the second partner, his son, and later that son was taken as a partner.

Subsequently, the third partner--another son of the assessee--was assisting him in the business and later he was also taken into partnership. It is

these three partners who brought into existence the partnership deed dated January 1, 1962, under which the share of profits as between the three

partners was fixed as 40 : 35 : 25. Thereafter, the very same three partners brought into existence a new partnership deed on January 1, 1964, in

which the share of profits was redetermined as 25 : 40 : 35. Consequently, it is clear that the redistribution of the profits which alone has been held

to be the gift, was made in the course of carrying on the business. Then the other question is whether the gift was made bona fide for the purpose

of the business. The Tribunal has pointed out that the document dated January 1, 1964, while stating the reason for reduction in the assessee's

share ""of profits in the partnership firm recited, that the first partner having become old and has to devote more attention to his new business of

Mekala Talkies, the work of the 2nd and 3rd partners in the partnership business, M/s. Norton & Co., had considerably increased. This will

clearly show that the redistribution of the shares of profit was for the purpose of the business. The Tribunal also stated : "" evidence on record

establishes that the reduction in the share of profit of the appellant was brought about in a bona fide manner and for the effective and profitable

working of the partnership firm. Since there is no indication or suggestion that the reconstitution of the firm as evidenced by the partnership deed

dated January 1, 1964, was brought about for any mala fide purpose and since such a reconstitution and consequent reduction of the assessee's

share in the partnership firm were also brought about on an earlier occasion by a partnership deed dated January 1, 1962, we are convinced that

the case falls within the ambit of the exemption u/s 5(1)(xiv) of the Gift-tax Act and consequently not exigible to gift tax "". Consequently, even the

bona fides of the gift was not questioned before the Tribunal and, therefore, the Tribunal was fully justified in holding that the gift in question falls

within the scope of Section 5(1)(xiv).

9. Mr. Jayaraman, the learned counsel for the department, contended that the reason for redistribution given in the partnership deed dated January

1, 1964, was also given in the partnership deed dated January 1, 1962, and, therefore, it could not be said to be a real reason and the gift cannot

be said to be for the purpose of the business. We are unable to accept this argument. As a matter of fact, the recital contained in the partnership

deed dated January 1, 1962, is different. The recitals in that deed are :

AND WHEREAS, as such the said Mekala Talkies is the personal business of the first partner, in the conduct of the affairs of which the First

partner has to devote a large amount of attention AND WHEREAS in view of the increasing amount of work involved in the conduct of the said

partnership business, Norton & Co., the second and third partners have requested the first partner to allow them an increase in their share of

profits of the said partnership business, Norton & Co.

Apart from the recitals in the two deeds being different, there is one crucial circumstance which will make the recitals in both the deeds bona fide

and true. Even though the partnership deed dated January 1, 1962, referred to Mekala Talkies as the personal business of the first partner, the business had not yet commenced on the date when the partnership deed came into existence on January 1, 1962, and the business started functioning only from January 14, 1962, as is clear from the partnership deed dated January 1, 1964, Therefore, the time and attention which the first partner had to pay towards Mekala Talkies as on January 1, 1962, was not the same as he had to pay on January 1, 1964, the business itself having started functioning only during the interval between the two dates. Therefore, we are unable to agree with the contention of the learned counsel for the department that simply because there was such a recital in the partnership deed dated January 1, 1962, the Tribunal should not have accepted the recitals contained in the partnership deed dated January 1, 1964, as the real reason for the redistribution of the shares of profits of the partners.

10. Lastly, it was contended by Mr. Jayaraman, that, in any event, the partnership deed dated January 1, 1962, provided that the goodwill of Norton & Co. shall be the exclusive asset of the first partner, namely, the assessee, while the partnership deed dated January 1, 1964, was silent with regard to this aspect thereby leading to the inference that all the three partners shared the goodwill equally between them and, consequently, there was at least the gift of 2/3rds of the goodwill by the assessee in favour of his two sons, namely, the other two partners. Admittedly, such a question was not agitated before any of the authorities below and was not put forward before the Tribunal and the Tribunal had no occasion to consider such a case. As a matter of fact, even though the Gift-tax Officer, for the purpose of valuing the 15% share of the profits, took the value of the good will into account, he did not proceed on the basis of there having been a gift of 2/3rds of the goodwill itself by the assessee in favour of the other two partners and in view of this, this question was never considered by any of the authorities and hence it cannot be said that it arises out of the order of the Tribunal so as to justify this court in dealing with such a question.

11. Under these circumstances, we answer the second question referred to above in the affirmative and against the department. The assessee will

be entitled to his costs of this reference. Counsel's fee is fixed at Rs. 500.