(1986) 09 AP CK 0014

In the Andhra Pradesh High Court

Case No : Income Tax C. No. 199 of 1985

Commissioner of Income Tax APPELLANT

Vs

Anasuya Devi RESPONDENT

Date of Decision : 22-09-1986

Acts Referred:
Income Tax Act, 1961 — Section 2(47), 256(2)

Citation : (1987) 168 ITR 587

Hon'ble Judges : Y.V. Anjaneyulu, J;B.P. Jeevan Reddy, J

Bench : Division Bench

Advocate : M. Suryanarayana Murthy, for the Appellant; A. Satyanarayana, for the Respondent

Judgement

Y.V. Anjaneyulu, J.—This application u/s 256(2) of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), is filed by the Commissioner of Income Tax seeking to raise the following five questions of law :

"1. Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in holding that the property ceased to be a capital asset at the time when it became the property of the firm ?

2. Whether, on the facts and in the circumstances of the case, the conclusion drawn by the Appellate Tribunal that the property ceased to be capital asset and became the stock-in-trade of the co-owners is supported by any relevant and valid material and whether such conclusion of the Appellate Tribunal is not perverse ?

3. Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in stating that the excess contribution over and above Rs. 6,00,000 in terms of value allowed to be withdrawn does not in any way suggest that there has been a sale ?

4. Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is justified in holding that no transfer is involved when a

partner brings in property as a share of capital and no profit arises on the basis of mere agreed valuation adopted for ascertaining inter se right between coparceners ?

5. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is justified in dismissing the alternative claim of the Revenue for treating the amount or any part of the same as business profits in the absence of any sale or transfer ?"

2. The Tribunal declined to refer any of the five questions to this court u/s 256(1) of the Act and hence this application u/s 256(2) of the Act.

3. It is not necessary to set out the facts in great detail. It is perhaps enough if we refer to the salient facts which have a bearing on the questions sought to be referred. The assessee and her two sons are co-owners of building in Himayatnagar, Hyderabad. The property was under self-occupation. As the property was situate in a lucrative locality, the assessee and her sons thought of converting the property as a commercial asset and entered into an agreement of partnership with Tirumala Construction Company on March 16, 1979. According to the terms of the partnership, the property owned by the assessee and her sons was thrown into the common stock of the partnership so that the property became partnership property u/s 14 of the Partnership Act. In consideration of the assessee and her two sons throwing the property in to the partnership stock, their capital accounts were credited with a sum of Rs. 8,00,000 in agreed shares. The question that arose for consideration in the Income Tax assessments was whether the assessee, as the co-owner of the property, was liable to be taxed on the difference between the cost of the property and the consideration credited to the assessee''s capital account in the books of the partnership firm.

4. A contention was urged before the Revenue that the property was converted into a business asset (stock-in-trade) prior to throwing the same into the partnership stock and consequently what was thrown into the partnership stock was stock-in-trade and not a capital asset. The assessee also contended that the unilateral act of throwing the property into the partnership stock did not amount to a transfer and consequently no liability to tax arose. The Tribunal accepted the assessee''s contention and held that there is no liability to tax. In particular, the Tribunal held that the transaction did not amount to a transfer.

5. Our attention has been invited to the decision of the Supreme Court in Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat, , where an identical question came up for consideration. Learned counsel for the assessee, Sri A. Satyanarayana, contends that in view of the decision of the Supreme Court, the decision of the Tribunal is correct, although the Tribunal''s decision was not based on the reasoning advanced in the decision of the Supreme Court.

6. There is some factual difficulty in appreciating the assessee''s contention that there was conversion of the capital asset into stock-in-trade at an earlier point of time. The Revenue is perhaps justified in contending that the evidence is not

categorical that there was a conversion by the assessee and her two sons of the capital asset into the stock-in-trade at an earlier point of time. It is, therefore, not necessary to go into this question in the present matter. We may proceed on the basis that the asset continued to be a capital asset till it was thrown into the partnership stock by the assessee and her two sons, accepting the Revenue''s contention that there was no conversion into stock-in-trade at an earlier point of time.

7. Once it is held that the capital asset was thrown into the partnership stock pursuant to the partnership agreement dated July 16, 1979, there can be little dispute that the decision of the Supreme Court in Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat, becomes applicable. In view of that decision, it must be held that there is a transfer within the meaning of section 2(47) of the Income Tax Act when the partners unilaterally threw the asset into the partnership stock. But then, the Supreme Court observed that the claim for levy of tax on the capital gains cannot be sustained. We may quote the following observations of the supreme Court (p. 522) :

"When his personal asset merges into the capital of the partnership firm, a corresponding credit entry is made in the partner''s capital account in the books of the partnership firm, but that entry is made merely for the purpose of adjusting the rights of the partners inter se when the partnership is dissolved or the partner retires. It evidences no debt due by the firm to the partner. Indeed, the capital represented by the notional entry to the credit of the partner''s account may be completely wiped out by losses which may be subsequently incurred by the firm, even in the very accounting year in which the capital account is credited. Having regard to the nature and quality of the consideration which the partner may be said to acquire on introducing his personal asset into the partnership firm as his contribution to its capital, it cannot be said that any income or gain arises or accrues to the assessee in the true commercial sense which a businessman would understand as real income or gain."

8. In view of the aforesaid observations of the Supreme Court, it cannot be said that the assessee and her two sons acquired, on introducing their personal asset into the partnership firm as their contribution towards capital, any gain in a commercial sense. The capital represented by the notional entry of Rs. 8,00,000 to the credit of the assessee and her two sons may be completely wiped out by losses which may be subsequently incurred by the partnership firm. Thus, it is not possible to hold that on the transfer of the capital asset, any capital gain liable to assessment resulted.

9. Learned standing counsel, however, invited our attention to the observations of the Supreme Court that it will be open to the Income Tax authorities to go behind the transaction and examine whether the transaction of creating the partnership is genuine or sham transaction and even where the partnership is genuine, whether the transaction of transferring the personal asset to the partnership firm represents a real attempt to contribute to the share capital of

the partnership firm for the purpose of carrying on the partnership business or is nothing but a device or ruse to convert the personal asset into money substantially for the benefit of the assessee while evading tax on capital gain. It is true that, in the light of the aforesaid observations of the Supreme Court, the Income Tax Officer will be entitled to consider all the relevant indicia in this regard and come to an appropriate conclusion. The Income Tax Officer may even now investigate into the aspects referred to by the Supreme Court and take appropriate action, if called for.

10. Having regard to all the aforesaid facts and circumstances, we do not consider that any of the five questions arises for consideration. We accordingly dismiss this application.

