
(1998) 03 KL CK 0048

In the High Court Of Kerala

Case No : Income-tax Reference No. 84 of 1996

Commissioner of Income Tax

APPELLANT

Vs

Jacobs (P.) Ltd.

RESPONDENT

Date of Decision : 13-03-1998

Acts Referred:

Citation : (1998) 148 CTR 613 : (1999) 237 ITR 433

Hon'ble Judges : Om Prakash, C.J.;J.B. Koshy, J

Bench : Division Bench

Advocate : P.K.R. Menon and N.R.K. Nair, for the Appellant; C. Kochunni Nair and M.C. Madahavan, for the Respondent

Judgement

Om Prakash, C.J.—The Income Tax Appellate Tribunal at the instance of the Revenue referred the following questions for the opinion of this court :

"(1) Whether, on the facts and in the circumstances of the case, there was a gift by the assessee liable to be brought to tax under the Gift-tax Act ?

(2) Whether, on the facts and in the circumstances of the case, the transfer in order to be valid needs registration ?

(3) Whether, on the facts and in the circumstances of the case, the Tribunal is right in law and fact in holding that the consideration for which the asset was transferred cannot be ascertained with any degree of certainty and that the transfer cannot be brought within the purview of Section 4(1)(a) of the Gift-tax Act ?"

2. The assessee is a company in which the public are not substantially interested. It is engaged in the business of liquor distribution. With effect from April 1, 1979, the assessee was admitted as a partner into a partnership firm, known as J'kobs at Ernakulam. In accordance with Clause 4 of the partnership deed dated April 1, 1979, the assessee's contribution towards capital was fixed at Rs. 5 lakhs and the contribution by the remaining partners was determined at Rs. 25,000 each.

The assessee contributed towards capital in the firm its land and building, which was valued by the Department at Rs. 10,18,000 at the instance of the Gift-tax Officer. But in the books of the firm, the written down value of such asset was credited only at Rs. 6,12,844. The difference between the two was treated as deemed gift, u/s 4(1)(a) of the Gift-tax Act and accordingly that was brought to tax for the assessment year 1980-81.

3. On appeal, the Commissioner of Income Tax (Appeals) affirmed the order of the Gift-tax Officer.

4. The assessee carried the dispute further in appeal before the Income Tax Appellate Tribunal, which, relying on *Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat*, held that on the facts and in the circumstances of the case inadequacy of consideration could not be ascertained and, therefore, no gift could be said to have been made. This is how the case of the assessee was accepted.

5. In *Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat*, the Supreme Court summed up the legal position as under (headnote) :

"Where a partner of a firm makes over capital assets which are held by him to a firm as his contribution towards capital, there is a transfer of a capital asset within the terms of Section 45 of the Income Tax Act, 1961, because an exclusive interest of the partner in personal assets is reduced, on their entry into the firm, into a shared interest.

The consideration for the transfer of the personal assets is the right which arises or accrues to the partner during the subsistence of the partnership to get his share of the profits from time to time and, after the dissolution of the partnership or with his retirement from the partnership, to get the value of his share in the net partnership assets as on the date of the dissolution or retirement after deduction of liabilities and prior charges. The credit entry made in the partner's capital account in the books of the partnership firm does not represent the true value of the consideration. It is a notional value only, intended to be taken into account at the time of determining the value of the partner's share in the net partnership assets on the date of dissolution or on his retirement.... It is impossible to conceive of evaluating the consideration acquired by the partner when he brings his personal asset into the partnership firm when neither can the date of dissolution or retirement be envisaged nor can there be any ascertainment of liabilities and prior charges which may not have even arisen yet. Therefore, the consideration which a partner acquires on making over his personal asset to the firm as his contribution to its capital cannot fall within the terms of Section 48. And as that provision is fundamental to the computation machinery incorporated in the scheme relating to the determination of the charge provided in Section 45, such a case must be regarded as falling outside the scope of capital gains taxation altogether."

6. Concludingly, the Supreme Court said that 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.

7. In order to attract the provisions of Section 4(1)(a) of the Act--(1) there must be a transfer of property ; (2) the consideration for the transfer must be inadequate ; and (3) the market value of the property should be more than the consideration for which the transfer was effected. No doubt, when the asset was brought to the partnership firm by the assessee as contribution towards its capital, there was a transfer in the limited sense as held in *Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat*, , inasmuch as, the individual ownership of the assessee over the asset stood reduced into a shared interest. But to attract Section 4(1)(a), the Revenue has to establish further that the consideration for the transfer was inadequate and that the market value of the asset exceeded the consideration for which the asset was transferred to the firm. It is here that the ratio of *Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat*, becomes more significant. The case of the Revenue is that whereas the market value of the asset as per the Government valuer's report was Rs. 10,18,000, only the written down value of the asset, viz., Rs. 6,12,844 was credited in the books of the partnership firm. The point for decision is whether the credit entry made in the capital account of the firm's books represented the true value of the consideration. The Supreme Court in *Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat*, unequivocally ruled down that the credit entry in the capital account does not represent the true value of the consideration and that such entry simply represented the notional value of the asset. It means that the inadequacy of consideration cannot be judged vis-a-vis the credit entry made in the capital account of the assessee in the books of the firm. Except the credit entry, made in the capital account, there is nothing else on the record to conclude that the assessee had transferred its asset to the firm for inadequate consideration. Thus, the Revenue has been able to establish only one ingredient, that there was transfer, but the remaining ingredients, that there was inadequate consideration and that the market value exceeded the actual consideration have not been established.

8. On these facts, Section 4(1)(a) cannot be applied and no inference of deemed gift could be drawn.

9. Similar question came up for consideration in *N. Prasanna Vs. Commissioner of Gift Tax*, before the Karnataka High Court. The fact matrix of the case was that the assessee was the owner of two sites, which were valued at Rs. 4,50,000 by an approved valuer in connection with his wealth-tax assessment for the assessment year 1979-80. He entered into a partnership with his mother and contributed the said two sites as his capital at a value of Rs. 1,35,000.

Subsequently, the firm was reconstituted by inducting the assessee's father as a partner resulting in a change in the profit-sharing ratio of the partners. The Gift-tax Officer held that the contribution of the sites towards the capital of the firm amounted to transfer and determined the value of the sites as Rs. 6,00,000. As the assessee had contributed the sites to the firm valuing them at Rs. 1,35,000, he treated the difference in value, viz., Rs. 4,65,000 as a gift by the assessee to the firm and made an assessment subjecting the same to gift-tax. The Karnataka High Court, following the principle laid down in the case of *Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat*, , held that the value of the consideration received by the partner as a result of the "transfer" of the capital assets, which can be inferred from the assets being contributed as capital, is incapable of ascertainment in monetary terms at the time of such transfer and that the amount credited to the partner's account at the time of such transfer cannot represent the true value of the consideration. It, therefore, follows that if the consideration for the transfer of the capital assets by the partner to the firm is incapable of ascertainment at the time of such transfer, the question of inadequacy of consideration would not arise. Hence, there can be no deemed gift, as contemplated u/s 4(1)(a), said the Karnataka High Court.

10. In the case at hand, we are not concerned with a gift, which is a transfer without consideration, but with a deemed gift created by a legal fiction u/s 4(1)(a) of the Act. The transaction is not sought to be taxed as a transfer without consideration, but as a deemed gift arising u/s 4(1)(a). To determine the extent of deemed gift, contemplated u/s 4(1)(a), consideration is the relevant factor, as a deemed gift under the said provision arises where the property is transferred otherwise than for adequate consideration, that is, for inadequate consideration. When the question relates to the extent or adequacy of consideration for the transfer arising from a transaction where a partner contributes his individual property to the partnership, the decision in *Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat*, , which holds that the consideration for such a transfer is unascertainable until the dissolution of the partnership, becomes relevant and applicable. The principles laid down relating to consideration in the said decision with reference to transfer of an asset by a partner to the firm, as a capital contribution apply with equal force to the case at hand as well. In the absence of any explicit provision providing that the amount recorded in the books of account of the firm, as the value of the capital asset contributed by the partner to the firm, shall be the consideration received or accrued as a result of the transfer of the capital asset, it is impermissible to treat the amount credited in the capital asset in the books of account of the firm, as the consideration for the transfer for the purposes of Section 4(1) of the Act. In the absence of an explanation or deeming provision in the Gift-tax Act, that the amount recorded in the books of account of the firm, as the value of the capital asset contributed by a partner, is the deemed consideration for the transfer, the said amount cannot form the basis to determine the adequacy of consideration vis-a-vis the fair market value of the property. Hence, it has to be held that

though a contribution by a partner of his individual property towards the capital ,of the firm, amounts to "transfer of property" for the purpose of the Gift-tax Act, there cannot be a deemed gift in such a case for the purpose of gift-tax, as it is not possible to determine the "adequacy" of consideration.

11. Since we have held that in view of the dictum of the Supreme Court in the case of Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat, , contribution of the asset towards capital into the partnership firm would amount to transfer, inasmuch as the exclusive ownership over the asset is substituted by the shared interest in the firm, it is not necessary to go into the question whether the transfer requires to be registered, as observed by the Appellate Tribunal.

12. In the light of our above findings, we answer the aforementioned question No. 1 in the negative and question No. 3 in the affirmative, that is, in favour of the assessee and against the Revenue.