

(1968) 06 MAD CK 0013

In the Madras High Court

Case No : Tax Case No. 277 of 1964 (Reference No. 76 of 1964)

Commissioner of Income Tax

APPELLANT

Vs

Janab N. Hyath Batcha Sahib

RESPONDENT

Date of Decision : 25-06-1968

Acts Referred:

Income Tax Act, 1922 — Section 10(2)
Partnership Act, 1932 — Section 14, 4

Citation : (1969) ILR (Mad) 220 : (1969) 72 ITR 528

Hon'ble Judges : Veeraswami, J; Ramaprasada Rao, J

Bench : Division Bench

Advocate : V. Balasubrahmanyam and J. Jayaraman, for the Appellant; S. Padmanabhan, for V. Srinivasan, for the Respondent

Judgement

Veeraswami, J.—The question in this reference relating to the assessment year 1960-61 is whether a sum of Rs. 12,442 was liable to be

assessed to tax u/s 10(2)(vii) of the Income Tax Act, 1922, Till the year ended March 31, 1959, the assessee was carrying on business in forest

contracts. For purposes of that business, he owned three lorries which were valued in its books, as on March 31, 1959, at Rs. 15,925. The

written down value of the lorries as on that date, as per the assessment records, was Rs. 2,558. By a deed of partnership dated August 5, 1959,

the proprietary business of the assessee was converted into a firm of partnership consisting of himself and another by name V. Abdul Kayoom.

The partnership as agreed between the two was to commence as and from April 1, 1959, and it was to be one at will, determinate by either party

by notice of a specified period. The net profits and losses of the partnership were to be divided or borne by the partners in the proportion of 9

annas and 7 annas in the rupee as between the assessee and the other partner respectively. Each partner was to contribute a sum of Rs. 4,000

towards initial capital of the firm. Any additional capital needed for the purposes of the partnership business was to be contributed equally by the

parties. The three lorries were brought into the assets of the firm and the clause in the partnership deed relating to it reads :

The capital account of the party of the first part shall be credited with a further sum of Rs. 15,000 being the agreed value of the three lorries

handed over to the partnership business by the party of the first part on the 1st day of April, 1959.

2. In the accounts of the firm, the assessee's capital account was credited with a sum of Rs. 15,000 and the lorry purchase account was debited

with a similar amount. It will be seen that there was thus a difference of Rs. 12,442 between the value at which the lorries have been taken over by

the firm and their written down value. This sum of Rs. 12,442 was treated as profit made by the assessee and brought to tax u/s 10(2)(vii). The

Appellate Assistant Commissioner of Income Tax declined to interfere, but, on a further appeal, the Tribunal held that, in the circumstances! there

was no sale of the lorries and so no profit made by the assessee. This reference comes before us u/s 66(1) at the instance of the Commissioner of

Income Tax.

3. We are of the view that the Tribunal was right in its conclusion. The revenue places strong reliance on the entries in the firm's account books

and contends that the debit of Rs. 15,000 in the firm's lorry purchase account with the corresponding credit given to the assessee's capital account

clearly pointed to a transfer by the assessee of the lorries to the firm for consideration, the transaction amounting thus to a sale of goods within the

meaning of the Sale of Goods Act, 1930, and that the bringing in of the lorries into the firm's business was not merely a re-adjustment made by the

partners so as to carry on the business in one form rather than in another, as was viewed by the Tribunal. If the entries in the account books stood

by themselves, there may be some force in the contention for the revenue. But even there, we doubt whether on the basis of the entries alone we

can hold that there was a sale by the assessee to, and purchase by the firm, of the lorries. For Section 10(2)(vii) to apply there must be a sale of

goods. Though the concept is not defined in the Income Tax Act, it is now established by *The Liquidators of Purna Limited Vs. Commissioner of*

Income Tax, Bihar, . and *Commissioner of Income Tax v. Dewas Cine Corporation*, [1968] ITR 240. that the word "" sale "" has been used in

Section 10(2)(vii) in the sense of sale of goods as defined in the Indian Sale of Goods Act, 1930. Whether there is a sale of goods will depend

upon the facts in each case and the mere entry in the account books, when its effect is in dispute, is not conclusive of the matter To constitute a sale

of goods, there should be a contract between the seller and the purchaser by which the former transfers to the latter the property in the goods for a

price. The existence of a contract presupposes that there must have been an offer to buy or sell goods for a price and the acceptance of such offer.

We are unable to say that these elements in the formation and execution of a contract of sale are present in the transaction of making over the

lorries to the firm. The lorries are transferred or handed over at the commencement of the firm's business, though the contract of partnership has

been entered into on a subsequent date. The preamble to the partnership deed recites, and this has been noticed in the statement of the case, that

the partnership has been thought of because of the indifferent health of the assessee and his inability to attend to the business. That was the reason

why, while the assessee wanted to continue the business, he sought the assistance of the other partner in achieving that object. No doubt, a

partnership is treated as an entity for certain purposes, as for instance by the Income Tax Act for purposes of assessment of firms of partnership or

the CPC for purposes of procedural matters or the law merchant. But barring the exceptional cases of limited recognition of a firm of partnership

as an entity, the normal position in law of a firm is that it is not a legal entity, unlike an incorporated company. A firm is but a convenient and

compendious name given to a contractual relationship in which two or more persons combine their efforts and conjointly apply the same to a

commercial or business activity with a view to make profit. Section 4 of the Indian Partnership Act makes this explicit and says that a "" partnership

is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. This relationship

does not appear to cloud or destroy the identity of the partners whose rights and liabilities vis-a-vis each other are governed by the terms of the

partnership and the provisions of the Indian Partnership Act. The members of a firm, from a certain point of view, therefore, remain as co-owners

in a limited sense and subject to the terms of the contract of partnership and the principles of law governing such relationship. When, therefore, A

makes over his property to a firm consisting of A and B, it will be a nice question--whether the transaction involves a transfer of the property. By

such a transfer A clearly does not divest himself completely of his rights or interest in the property, though it is true B, by reason of the transaction,

becomes entitled to certain rights which are regulated by the terms of the agreement of partnership, as well as the provisions of the Indian

Partnership Act. Where the making over of tangible assets, movable or immovable, is by a certain set of persons to an incorporated company in

which the same set of persons hold the entirety of the shares, it has been held that, notwithstanding the corporate character of the company, and

because of the identity of the persons involved, there is no transfer. In COMMISSIONER OF Income Tax, KERALA Vs. MORNING STAR

BUS SERVICE., . an association consisting of five persons engaged in transport business formed themselves into a private limited company. The

assets of the association, including a few buses, were transferred to the company. The revenue sought to charge the difference between the written

down value of the buses in the books of the association and their value as shown in the books of the company, under the second proviso to

Section 10(2)(vii). M. S. Menon C. J. and Govindan Nair J. held that, though the association and the private limited company were different legal

entities and, in a strict legal sense of the term, there was a sale of the buses by the association to the private limited company, yet, as the persons

who owned the buses before and after the transfer were identically the same persons, in substance and fact and in a commercial sense there was

no sale but there was only a readjustment for the purpose of carrying on the business in another form. On that view, they held that the charge could

not be sustained. The learned judges derived support from Rogers and Co. Vs. Commissioner of Income Tax, Bombay City-II, for the view they

took. We find that Liquidators of Pursa Ltd. v. Commissioner of Income Tax shares the view. The Patna High Court in Maharajadhiraj Sir

Kameshwar Singh Vs. Commissioner of Income Tax, has struck a different note and took the view that in such a case the corporate personality

cannot be allowed to be pierced so as to allow the identification of the individual with the company, in order to promote his own benefit or

advantage. But we are inclined to think that the assessee, having regard to the circumstances in which he entered into the partnership, did not

intend a transfer of the lorries with a view to completely divest himself of his interest therein. Whatever may be the position when an association of

persons converts itself into an incorporated company, in the case of one or more persons forming a firm of partnership, the question of transfer

does not meet with any corporate character and the necessity to pierce its veil. Once we regard a firm as not a legal entity, we fail to recognise any

half way house. It should follow, therefore, that when A, as an individual, hands over his property to A and B constituting a firm of partnership,

there is no transfer of property involved. In any event, there is no such transfer of property so as to constitute a sale of goods as defined in the

Indian Sale of Goods Act, for, as we are inclined to think, A by that transaction has not completely divested himself of his rights therein. In our

opinion, therefore, the credit of Rs. 15,000 in the capital account of the assessee with the firm and the debit of a similar sum in the purchase

account of the firm do not necessarily point to there having been a sale of goods. In fact, the purchase entry with the corresponding credit entry

should be interpreted or understood in the light of Clause 6 of the agreement of partnership which we have extracted above. This clause does not

speak of any sale or purchase. It is preceded by a clause which prescribes Rs. 8,000 as the capital of the partnership which should be equally

contributed by the two partners. And Clause 6 says that the capital account of the assessee shall be credited with a further sum of Rs. 15,000

being the agreed value of the three lorries handed over to the partnership business by him. In substance, what is contributed by the assessee to the

firm are the three lorries which for purposes of accounting have been valued at Rs. 15,000. The process of handing over of the three lorries by the

assessee to the firm, valuing them at Rs. 15,000 and credit of that sum being given to the assessee in his capital account with the firm do not by any

means show that the parties by the transaction intended any sale or purchase. Mr. Balasubrahmanyam, for the revenue, stresses once again that the

debit in the purchase account of the firm read with Clause 6 of the terms of the partnership agreement does not negative a sale of goods. We are

clearly of opinion that the contention is not correct.

4. After all, the Income Tax Act charges income, profits and gains made by an assessee. We fail to see what income, profit or gain the assessee

made only by handing over the lorries to the firm. The debit in the purchase account and the credit in the capital account are but mere entries

without the assessee actually getting in his hands the sum of Rs. 15,000. But we need not base our conclusion on this reasoning. Apart from the

foregoing, there are other weighty reasons for concurring with the view of the Tribunal. Section 14 of the Indian Partnership Act shows the

different process or methods by which a firm of partnership may come to possess property. The section says "" the property of the firm includes all

property and rights and interests in property originally brought into the stock of the firm or acquired, by purchase or otherwise, by or for the firm.

This is, of course, subject to the contract between the partners. When a partnership is formed for the first time and one of the members of the

partnership brings into the firm assets, they become the property of the firm, not by any transfer, but by the very intention of the parties evinced in

the agreement between them to treat such property belonging to one or more of the members of the partnership as that of the firm. This view

receives support from Firm Ram Sahay Mall Rameshwar Dayal and Others Vs. Bishwanath Prasad, , Prem Raj Brahmin v. Bhani Ram Brahmin,

ILR [1946] 1 Cal. 191, and Commissioner of Income Tax v. Dewas Cine Corporation. In the last of these cases, the Supreme Court expressed

the view :

When the two partners brought in the theatres of their respective ownership into the partnership, the theatres must be deemed to have become

the property of the partnership..... "Sale", according to its ordinary meaning, is a transfer of property for a price, and adjustment of the rights of

the partners in a dissolved firm is not a transfer, nor it is for a price.

5. In principle what applies to dissolution equally applies to the earlier stage of formation of partnership and handing over of assets to the firm by

one or more of its members. Section 48 of the Indian Partnership Act makes a distinction between advances made by a partner and the capital

contributed by him, for purposes of settlement of accounts between partners at dissolution and in the matter of settlement of priorities of rights and

liabilities.

6. Clause 6 of the partnership agreement unmistakably indicates that the lorries of the value of Rs. 15,000 were contributed by the assessee as

further capital. As pointed out by Lindley :

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.

7. Lindley also distinguishes between capital of a partner and the property of a firm and says that capital is not by any means a debt of the firm. We

are inclined to think that, in view of the terms of Clause 6 of the partnership agreement and the other circumstances, the sum of Rs. 15,000

credited in the assessee's capital account is not a price for sale of goods.

8. The reference is answered against the revenue with costs. Counsel's fee, Rs. 250.