

(2002) 11 MAD CK 0086
In the Madras High Court
Case No : Tax Case No. 54 of 1999

K. Shanmuganathan

APPELLANT

Vs

Commissioner of Gift Tax

RESPONDENT

Date of Decision : 26-11-2002

Acts Referred:

Gift Tax Act, 1958 — Section 4(1)

Citation : (2003) 181 CTR 529 : (2003) 264 ITR 431

Hon'ble Judges : N.V. Balasubramanian, J;K. Raviraja Pandian, J

Bench : Division Bench

Advocate : V.S. Ramakrishnan, for the Appellant; Pushya Sitharaman, for the Respondent

Judgement

N.V. Balasubramanian, J.—This is reference under GT Act and the questions of law referred to us read as under:

"1. Whether, on the facts and in the circumstances of the case when the proprietary concern was converted into a partnership with a capital contribution of other partners and when share of profits is commensurate with it, such conversion of the proprietary business into partnership could be treated as gift under the GT Act, 1958 ?

2. When the proprietary concern is converted into a partnership concern and the closing stock is transferred as its book value, whether it is necessary to value the closing stock at market value and arrive at the taxable gift ?"

2. The assessee, one M. Kathiresan, was carrying on the business in jewellery in the name and style of M/s Sujatha Jewellers from 1977. He continued the business upto 5th May, 1982, and from 6th May, 1982, the proprietary business was converted into partnership concern by taking in one Savithri, M.S. Kumaraguruparan and another K. Shanmugavelayutham as partners. The assessee's share of profit was 40 per cent and the other three partners were entitled to 20 per cent share each in the profit. The GTO was of the view that the

assessee had given up 60 per cent of his rights in the firm in favour of the new partners and also transferred the stock at closing stock value instead of market value. Hence, he held that there was a deemed gift within the meaning of Section 4 of the GT Act. The GTO computed the value of the interest gifted by the assessee at Rs. 77,648 on the basis of the super profits method by taking average maintainable profits after giving deductions for salary and interest on capital and capitalising it at 3 years' purchase price. The GTO also found that by transferring the stock of gold jewellery and silver at less than the market value, the assessee had made a deemed gift of Rs. 5,95,613 which was 60 per cent of the market value of the stock as on 5th May, 1982. In this view of the matter the GTO computed the total value of the gift at Rs. 6,73,261 made up of Rs. 5,93,613 and Rs. 77,648 and after deducting the basic exemption, he levied the gift-tax.

3. On appeal by the assessee before the CIT(A), the CIT(A) allowed the appeal preferred by the assessee. The Tribunal, however, on appeal by the Revenue, held that there was a gift by the assessee in favour of the three partners. The Tribunal also held that the three partners have contributed capital, subsequently, one of the partners Savithri availed the loan facility in a sum of Rs. 1,84,000. The Tribunal also held that there was a gift of goodwill and, therefore, the provisions of the GT Act would be applicable. As far as the value of the closing stock is concerned, the Tribunal applied the principles laid down by the Supreme Court in *A.L.A. Firm Vs. Commissioner of Income Tax, Madras*, and held that in a case where there is dissolution of the firm and when some of the partners are retired and new partners are introduced, the closing stock has to be valued only at the market price and not at the cost price. In this view of the matter, the Tribunal held that there was a deemed gift and the value determined by the ITO was also reasonable and allowed the appeal preferred by the Revenue. At the instance of the assessee, the reference has been made. It is stated that during the pendency of the appeal, M. Kathiresan died and the application for reference has been filed by his legal representative K. Shanmuganathan before the Tribunal. The Tribunal also recognised the same.

4. We heard Mr. V.S. Ramakrishnan, learned counsel for the assessee, and Mrs. Pushya Sitharaman, learned senior standing counsel for the Revenue. We find from the order of the GTO, that the GTO had considered the entire matter regarding the levy of gift-tax from two different angles and at two different heads. As far as the introduction of the partners, he held that the assessee has given up 60 per cent of his rights in favour of the new partners and, therefore, there was a deemed gift. However, the GTO as well as the Tribunal overlooked the fact that the new partners have contributed a sum of Rs. 20,000 each as capital when they became partners and the capital contribution by the new partners would be adequate consideration when they became partners in the firm. The three partners have received the share of profits by virtue of their capital contributions and, therefore, there is no question of any gift when the new partners have contributed their capital and their share of profits is also fixed

with reference to the capital contributed by them. As a matter of fact, it was found that the new partners were to share the profit only at the rate of 20 per cent each though the new partners have contributed a capital of Rs. 40,000 and Rs. 30,000 each. Therefore, we hold that it cannot be held that transfer was made without any consideration, as there was adequate consideration by way of capital contribution by the new partners and they were taken as partners and shared the profit of their contribution of capital. The fact that one of the partners availed the loan facility from the firm subsequently after she became a partner is not a ground to hold that the transfer was made without any consideration. We hold that as a partner she was entitled to draw loan from the partnership and when it was granted, it cannot be said that the transfer itself was made without consideration.

5. As far as the valuation of the closing stock of Rs. 5,95,613 is concerned, the Tribunal relied upon a decision of the Supreme Court in *A.L.A. Firm vs. CGT* (supra). The case of *A.L.A. Firm* is the case arising under the IT Act and the question that arose before the Supreme Court in *A.L.A. Firm*'s case was regarding the method of valuation of shares to be adopted when the firm stood dissolved. The Supreme Court held in the case of *A.L.A. Firm* that the closing stock of the firm has to be valued at the market price. Further, the decision in *A.L.A. Firm Vs. Commissioner of Income Tax, Madras*, is not applicable to the facts of the case.

6. Subsequently in *Sakthi Trading Co. Vs. Commissioner of Income Tax, Coimbatore*, the Supreme Court has held that since there was no cessation of business, the closing stock had to be valued at cost or market price, whichever is lower, as it is an established rule of commercial practice and accountancy that where there was no discontinuance of business, the closing stock is to be valued at cost or market price, whichever is lower by conversion. We are of the view that since the proprietary concern was converted into partnership, there was no cessation in the business as the firm continued the same business and therefore, the principles laid down by the Supreme Court in *Sakthi Trading Co. v. CIT* (supra) would apply and if it is applied, we hold that the method of valuation adopted by the GTO, which was upheld by the Tribunal, that the closing stock should be valued at the market price is not correct.

7. Further, the Supreme Court in *Reva Investment Pvt. Ltd. Vs. Commissioner of Gift Tax, Gujarat II*, has approved the view taken by this Court in *Commissioner of Gift-tax Vs. Indo Traders and Agencies (Madras) P. Ltd.*, and held that in order to constitute the deemed gift u/s 4(1)(a) of the GT Act, 1958, there must be appreciable difference in the value of the properties gifted and the parties deliberately showed the valuation of the gifted properties to evade tax. The Supreme Court also held that such a conclusion cannot be drawn merely because according to the AO there is some difference between the valuation of the property transferred and the consideration received. We are of the opinion that ratio of the decision of the Supreme Court in *Reva Investment (P) Ltd. v. CGT*

(supra) would apply as there is no finding that the valuation was done to evade tax. Further, the AO has not recorded any finding regarding inadequacy of the consideration and the Supreme Court has held that the finding as to inadequacy of the consideration is the essential sine qua non for application of the provisions of "deemed gift". Viewed from any angle, we are of the opinion that the Tribunal has committed serious error in holding that there was a taxable gift in the transaction. However, it is not open to the GTO to pick one of the assets and value the same for the purpose of levy of tax. The GTO should have valued the entire business as a whole and on that basis, he should have considered the question whether there was an inadequate consideration in the transfer. The GTO however, has picked only one of the assets of the assessee for the purpose of levy of gift-tax and we are of the view that it is impermissible to the GTO to pick only one of the assets for the purpose of valuation of the gift-tax. The Supreme Court in Commissioner of Gift-Tax, Kerala Vs. P. Gheevarghese, Travancore Timbers and Products, has held that GTO would not be justified in picking one single asset for the purpose of levy of gift-tax. Accordingly, we find that the Tribunal was not correct in holding that the transfer was made without any consideration and it is also not correct in holding that the closing stock should be valued at market price. Accordingly, both the questions of law are answered in favour of the assessee and against the Revenue. However, in the circumstances of the case, there will be no order as to costs.