(1961) 11 MAD CK 0027

In the Madras High Court

Case No : Tax Case No''s. 109 of 1958 and 81 of 1960

K.A. Subramaniam, Ambi's Cafe APPELLANT

Vs

Controller of Estate Duty, Madras RESPONDENT

Date of Decision : 22-11-1961

Acts Referred:

Citation : AIR 1962 Mad 315 : (1962) 46 ITR 1

Hon'ble Judges : S. Ramachandra Iyer, C.J;Srinivasan, J

Bench : Division Bench

Judgement

Ramachandra Iyer, C.J.—These two references arise under S. 64(1) of the Estate Duty Act during the course of assessment to duty of the

estate left by the late K.S. Ambi Iyer who was running a hotel at Madras .He died in a railway accident on 27th September 1954. He is survived

by his two sons who were living with him. One of them was a minor at the time of death. They are now the accounting persons for the purpose of

levy of estate duty. The deceased Ambi Iyer stared life by establishing a hotel at Vellore originally under the name of Ambika Lunch home and

later on as Ambi''s cafe. The business prospered and in course of time a meals section and lodging house were added to the coffe hotel. In 1935, a

branch of the business was opened at Broadway, Madras, very near the Law college where the premises were taken on lease. This business also

flourished .Some years thereafter the business at vellore was entrusted to other persons and ultimately it was closed doen. During the course of his

life, Ambi Iyer acquired several items of moveable and Immovable properties all of them together being now assessed to the value of Rs.

2,90,958. This valuation of the assets is not now contested. It also not disputed that the properties were acquired out of the income income from

the hotel business. But the accounting person contested before the assistant Controller of Estate Duty that the business run by the deceased was a

joint family business started with aid of ancestral nucleus in which the sons of the deceased (accountable persons) had an interest along with their

father and the entire property having survived to them the interest of the deceased which ceased on his death should be evaluated in accordance

with the provisions of S. 7 of the Estate Duty Act. They also stated that the goodwill of the business should be valued at Rs. 1,000. The Assistant

Controller, however, rejected the case that the business run by the deceased was a joint family concern and he therefore brought to duty the entire

estate left by the deceased Ambi Iyer as his separate property. The accountable persons who originally conceded that the goodwill attached to the

business of Ambi''s cafe had a value and estimated the same at Rs. 1,000, took up a different stand before the Assistant Controller namely that the

goodwill of the business had no value at all. The Assistant Controller refused to accept this plea and taking the average annual income on the basis

of the profits earned for years preceding the death of Ambi Iyer, he valued the goodwill attached to the business at three years'' purchase and

assessed it in a round figure of Rs. 45,000. There was an appeal by the accountable persons to the Central Board of revenue affirmed the view of

the Assistant Controller that the hotel business run by the deceased and the properties acquired from and out of the profits thereof were his

separate properties the accounting persons having no interest therein during the lifetime of the deceased. The Board, however, held that the value

fixed by the Assistant Controller for the goodwill of the business was excessive in view of the fact that the premises where the business was run did

not belong to the deceased, but was merely held under a precarious tenancy and reduced the value of the goodwill to Rs. 25,000/-. At the request

of the accountable persons the board has referred for the opinion of this Court the following two questions which respectively conform to the

subject of reference in T.C. No. 109 of 1958 and 81 of 1960.

1. Whether on the facts and circumstances of the case ,the estate of the late Ambi Iyer was a joint family property in which he had only one third

share or was it his separate property.

2. Whether the hotel business of Ambi Iyer had any goodwill had to be assessed as property, What was the basis of such assessment.

3. Question No. 1: As stated earlier there is no controversy that the properties left by the deceased were acquired by the late Ambi Iyer out of the

profits from his coffe hotel business run by him at Vellore and at Madras. The case for the business at Vellore was provided from and out of the

sale proceeds of an ancestral land owned by the deceased at Konunseri near Palghaf and that therefore the properties acquired from out of the

profits of the business would be joint family properties. It is clear from the evidence, that Ambi Iyer had obtained at a partition a small area of

agricultural land in Konnuseri in south Mallabar Dt. On 30th September 1924, that property was sold for a sum of Rs. 600/- The need for the sale

is not disclosed in the document. One Rao Saheb A rni Srinivasa Mudaliar who was at one time chairman of Arni Municipality has sworn to an

affidavit that the coffe hotel business at Vellore was started by the deceased Ambi Iyer in 1924, on his advice and that he advance loans on

occasions to the deceased Ambi Iyer.

2. There other affidavits are also in evidence. The first is by sivakrishana Iyer aged about 83 years who is the paternal uncle of the deceased. He

categorically states that Ambi Iyer, with the proceeds of the sale of his family property in Malabar started the coffe hotel business at Vellore. The

brother in law of the deceased one K. N. Krishna Iyer who subsequent took on lease the hotel business at Vellore has sworn to the same fact in

his affidavit. K. R. Swami Iyer a cousin of the associated with the latter right from the beginning when he started his business at Vellore confirms

that statement.

3. The Assistant Controller and the Central Board of Revenue have rejected the evidence afforded by these affidavits on the ground that no the last

three persons were closely related to the deceased and that it was highly doubtful whether Rao Sahib Srinivasa Mudaliar would have remembered

after all these years the exact year in which the late Ambi Iyer started his hotel business at Vellore. There was, however, no justification for the

Central Board of Revenue to doubt the veracity of these persons as there was no other evidence apart from a few circumstances which we shall

examine presently, to discredit them. The three relations of the deceased are possibly the best persons who could speak about the origin of the

business run by the deceased; indeed theirs was the only evidence before the authorities. If the Board of Revenuer suspected that the might be

interested, they should upon the accountable persons to produce those persons before them for the purpose of cross-examination as to their

knowledge, interest etc. This, however, was not open to the Central Board of Revenue to simply reject the uncontradicted evidence before them

and then that they say that there was no proof that the amount got from the sale of the ancestral property provided the nucleus for the starting of

the business by the deceased.

4. Apart from this the Central Board of Revenue has referred to the relevant circumstances which in their own view showed that the business was

not a joint family business. Reference is first made to two leases in respect of the Vellore business granted by the deceased in favour of K. N.

Krishna Iyer, wherein it has been mentioned that Ambi Iyer was the owner of the business. It is pointed out that there was no reference in those

documents show that the property and the business were those of the deceased but they do not say that they were his self-acquired properties. In

a joint Hindu family the father or the manager so completely represents the other coparceners of the family in regard to transactions with third

parties that it is not necessary for the names of the other members being mentioned therein or their behalf as well. No inference therefore can be

drawn either way by the mere fact, that the leases of the business were granted by the father in his own name.

5. The second circumstance relied on to discredit the evidence afforded by the affidavits is that the deceased while submitting his in-come tax

returns showed his status as an Hindu undivided family. There can no doubt that this conduct is against the contention of the accountable persons

particularly so because if the deceased had really been assessed as undivided Hindu family there should be a reduction in the amount of tax

payable. But it must be remembered that the accountable persons were born to the deceased only subsequent to the establishment of the hotel

business. It is just possible that originally the Income Tax returns were submitted as an individual by deceased and that practice was presumably

continued even after sons were born to him. In the absence of other evidence to show that Ambi Iyer ever claimed his business as his separate

property as against his sons, the assessment to Income Tax cannot be taken as decisive of the question of issue.

6. Sometime after Ambi Iyer''s death, his sons had to submit their returns as his legal representative in respect of the income earned from the

properties after the death of their father. It is stated that in such returns their status was shown as an individual. We cannot however, attach much

importance to this circumstance; for it cannot be otherwise when the sons were assessed in respect of their father''s liability on succession.

Secondly the probative value of this circumstance is considerably minimized when he find that almost simultaneously that is on 25-4-1955, the sons

have claimed in their letter to the In come-tax Officer Estate duty cum Income Tax Circle, Madras, that they were members of a joint Hindu family

along with their father and that the properties were joint family properties. None of the above circumstances evidence afforded by the affidavits.

7. It is clear on the materials in the case, that the Vellore business must have been started in 1924. Ambi Iyer who was a keen businessman would

not have frittered away the money he got by the sale of ancestral properties in the same year but on their hand he would in all probability have

invested it in the business. This is a reasonable inference from the fact that he sold his property in 1924 and the business at Vellore was also started

in the same year. We are, therefore of the opinion that on the materials on the records the only inference deducible is that Ambi Iyer started his

coffe hotel business at Vellore with the proceeds got by the sale of his ancestral property and that the business and acquisitions made from the

profits earned there form really formed part of the assets of the joint family, which survived to the accountable persons on the death of their father.

The estate left by Ambi Iyer should therefore be valued in accordance with S. 7 of the Estate Duty Act. We answer the question referred to us in

T. C. No. 109 of 1958 that the property is joint family property and in favour of the accountable persons.

8. Question No. 2: The first aspect of the question referred to us is substantially one of fact. We have only to consider whether there are materials

in the case to sustain the conclusion arrived at by the Assistant Controller and the Central Board of Revenue that the hotel business of the assessee had a goodwill. The goodwill of a business is the intangible value to it independent of its visible assets by reason of the business being a well

established one having a good reputation. Generally where the owner of a business sells it as such, the goodwill enables the purchaser to trade as a

recognised successor to the business. It has been recognised that the business reputation or goodwill owned by a partnership or by a company is a

valuable asset which can be disposed of at the time of the winding up of the concern. But at the same time it is obvious that goodwill is inseparable

from the business to which it adds value. In the Commissioner of Inland Revenue v. Muller and Co''s Margarine Ltd. 1901 AC 217, Lord

Macnaghten, observed:

What is goodwill? It is is a thing very easy to describe, very difficulty to define. It is the benefit and connection of a business. It is the attractive

force which brings in custom.

It is the thing which distinguish an old established business from anew business at its first start. The goodwill of a business must emanate from a

particular center or source. However widely extended or diffused its influence may be goodwill is worth nothing unless it has power of attraction

sufficient to bring customers home to the source from which it emanates. Goodwill is composed of a variety of elements. It differs in its composition

in different trades and it different business in the same trade. One element may prenderate here and elements there. To analyse goodwill and split it

up into its components parts, to pare it down as the commissioners desire to do until nothing is left but a dry residuum ingrained in the actual place

where the business is carried on while everything else is in the air, seems to me to be as useful for practical purposes as it would be to resolve the

human body into various substances of which it is said to be composed. The goodwill of a business is one whole and in a case like this it must be

dealt with as such.

9. Under the Estates Duty Act duty is payable on the principal value of the property passing or deemed to pass on the death of a person. Section

36 of the act defines the principal value as being the price which in the opinion of the Controller the property would fetch if sold in open market at

the time of the death of deceased."" It may be taken as well settled that in assessing estate duty the goodwill of the business left by the deceased would be taken as property passing on his death and in estimating the value of the estate the Controller will have to fix its value. An established

business with a reputation behind it generally consists of certain tangible assets and also the goodwill acquired by reason of its standing and

reputation, the use of the latter having an undoubted value to its successors. The value of the goodwill of a business while assessing estate duty will

therefore be the value which a reasonable and prudent buyer would give for the business as a going minus the value of the tangible assets.

10. As stated in ""Law of Death and Gift duties"" in New Zealand (2nd Edn.) by Adam

Goodwill has had many definitions. In death and duty matters, however, it simply means an additional value over and above the value of the

tangible assets which a reasonable prudent buyer would give for the business as going concern. In all these we have to as certain what hypothetical

purchaser would be likely to pay for the deceased''s or donor''s share there .To value the goodwill the value of the business and all its assets as a

going concern should first be obtained and from this should be deducted the value of the tangible assets leaving the balance as the true vale of the

goodwill.

11. Ambi''s Cafe at Madras was establishment as 1935 in an important locality. The accountable persons themselves originally admitted that there

was a goodwill attached to the business and valued it at Rs. 1000/- The business expanded considerably since its inception and the late Ambi

Aiyer himself thought it fit to close down his Vellore business probably for the reason of the increased prosperity of the Madras business. There

can be no doubt that on the materials available Ambi''s Cafe was an established business at the time of the death of Ambi Iyer. It should also have

acquired a reputation. We are therefore, of the opinion that the hotel business of the deceased had a goodwill. The next point for consideration is

how to value such goodwill. There can be no doubt that the nature and cass of assessing the value of the goodwill f a business.

12. Mr. Thiagarajan appearing for the accountable persons contended that as running of a coffe hotel business depended upon the skill of the

person managing it no goodwill value can be attached to such a business on his death. We cannot agree. The business of Ambi''s Cafe was admittedly a large one employing as it did a number of persons. The situation of the business in the heart of the City would undoubtedly have

contributed to acquire for it during all these years a reputation which can be said to be independent of the personal factor. After all Ambi Iyer did

nothing for the business except to manage it. The reputation of a hotel arises mostly by reason of the quality of the articles supplied by it. The

reputation of a hotel arises mostly by reason of the quality of the articles supplied by it and the amenities it provides for its customers. It was then

contended that as the reputation of the business was acquired purely out of its local situation no value could be attached to the goodwill as the right

to the premises which the business was run a precarious one having no market value.

13. In 1901 AC 217 Earl of Halsbury L.C. observed,

The right to trade under the name of a firm which has acquired a reputation is not confined to a particular locality or to any particular premises. The

right would remain if the business were transferred to another site else-where or if the premises were entirely altered. In the case of a public house

owing to the convenience of is situation and its being known as a favourite place of resorts, the advantages of its situation are so mixed up with the

goodwill of the business that as a matter of fact it may well be that it is very difficult to sever them and to say how much is goodwill and how much

is local situation. But those difficulties of fact will not necessarily make separate existence impossible.

14. Once such separate existence is possible the valuation has to be made under the provisions of section 36 of the Estates Duty Act. There are no

materials on records to show what the terms of the tenancy were under which the late Ambi Iyer held the premises for the purposes of his business

whether it was a lease for a term or one at will even assuming that the was one at will there was a statutory protection afforded to the lease by

reason of the Madras Building (Lease and Rent Control) Act, 1951. That statutory right was, of course, not alienable but it would have a value in

the hands of the legal representatives of the deceased who were given the same protection under the statue as the deceased. We are therefore, of

the opinion that, although the fact that the deceased had only a lease-hold interest in the business premises has a material bearing in valuing the goodwill of the business and although the locality of the business does contribute its own value to it, a proper valuation can still be made for the

goodwill after making due allowance for these matters.

15. The Assistant Controller considered while assessing the value of the goodwill of the business, the nature of the business, the risks involved, skill

in management location, future competition, trade name, money market conditions and trends of profits for five years immediately preceding the

date of valuation as a proper one. Mr. Thyagarajan contented that in so valuing the goodwill the Assistant Controller did not make allowance for

interest on the capital advanced. We shall presentably show that for making a rough and ready valuation that factor does not enter into

computation. The Central Board of Revenue took into consideration the absence of a long term lease arrangement in favour of the hotelier and

reduced the value to Rs.25000/- which works out to about 1 1/2 years assessed profits.

16. In J. R. Batliboi''s Advanced Accounting (20th Edn at page 888) it is stated that a rough for ascertaining the value of the goodwill of a business

is to take it as being worth one to three years'' purchase of the annual profits of the business such profits being based on the average annual profits

of the two to five years immediately preceding the date of such valuation without any deduction in respect in respect of interest on capital and

owner service. IT this principal that by adopted both by the Assistant Controller and by the Central Board of revenue, the former at three years''

purchase while the latter reducing it to nearly less than half thereof. It is no doubt true true if one of the two methods recognised in ""Diamonds

Death Duties"" 13th Edn. 511 were to be adopted, allowance has got to be made for interest on capital. But under that method the number of years

purchase will have to be increased. Taking the entire circumstances into consideration we cannot say that the procedure adopted by the Central

Board of Revenue is opposed to sound principles of accounting. While answering the question referred to us in T. C. No. 81 of 1960 in manner

indicated above we hold that the assessment of value of the goodwill attached to Ambi''s Cafe by the Central Board of Revenue is Unassailable.

There will be no order as to costs. Answer accordingly.

