

(1991) 02 MP CK 0012

In the Madhya Pradesh High Court

Case No : Miscellaneous Civil Case No. 451 of 1983

Mohanlal Hargovinddas

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 21-02-1991

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (1992) 102 CTR 39 : (1991) 188 ITR 556 : (1993) 38 MPLJ 371 : (1993) MPLJ 371 : (1991) 59 TAXMAN 447

Hon'ble Judges : R.D. Shukla, J; B.C. Varma, J

Bench : Division Bench

Advocate : H.S. Shrivastava, for the Appellant; B.K. Rawat, for the Respondent

Judgement

B.C. Varma, J.

At the instance of the assessee, M/s. Mohanlal Har-govinddas, Jawaharganj, Jabalpur, the following two questions of law have been referred to this court by the Income Tax Appellate Tribunal :

"1. Whether, on the facts and in the circumstances of the case, the inference drawn by the Tribunal that the payment of Rs. 36,292 made by the assessee to Shri Parmanandbhai Patel was prompted by extra-commercial considerations is justified ?

Whether, on the facts and in the circumstances of the case, the claim of the assessee to deduct a sum of Rs. 36,292 representing payment to Sri Parmanandbhai in computation of its business income is allowable ?"

The assessee is a partnership firm. It had two partners : (1) Smt. Ujjambai, and (2) Shri Parmanandbhai Patel. Later, a third person, by name, Shrivankumar, also joined the partnership. Parmanandbhai Patel became partner of the firm on June 21, 1961. He, however, withdrew from the partnership in September, 1963, as he wanted to contest the election of Member of Legislative Assembly which he ultimately won and became a member of the council of Ministers. After

relinquishing the office of Minister, Parmanandbhai Patel again joined the firm. When he withdrew from the firm, it was agreed that he shall be paid a sum of Rs. 50,000 per year in lieu of his share of the goodwill of the firm. It may be mentioned that, presumably because Parmanandbhai still wanted to join the firm back on his ceasing to be a member of the council of Ministers in this State, no final settlement of account was done nor was Parmanandbhai paid his share in the assets of the partnership including goodwill. The partnership-firm, after this agreement, claimed deduction of that amount of Rs. 50,000 Alleging that amount to be an expenditure laid out wholly for the purposes of business under the head "Profits and gains of business or profession". For the relevant assessment year 1975-76, a deduction of Rs. 36,292 under this head was claimed because, in the meanwhile, Parmanandbhai had rejoined the partnership-firm. The Income Tax Officer disallowed this claim. The assessee appealed successfully and the Commissioner of Income Tax (Appeals) allowed this deduction u/s 37 of the Income Tax Act, 1961. The Department took up an appeal before the Income Tax Appellate Tribunal and could succeed in persuading the Tribunal to accept that the deduction so claimed was not justified as Parmanandbhai did not contribute anything towards earning of the goodwill of the assessee-firm during his short span as partner in the firm. The Tribunal also observed, while allowing the appeal by the Department and rejecting the assessee's claim, that Parmanandbhai left the firm for good to become a politician and not to indulge in business activity of the firm or in parallel business detrimental to the business of the firm. The Tribunal finally held :

"Thus, on the totality of the circumstances, we hold that the payment made to Shri Parmanandbhai was not prompted by any commercial considerations and, as a matter of fact, it is on an extra-commercial consideration that the firm agreed to pay Shri Parmanandbhai Patel by way of share in the goodwill annually."

The Tribunal, therefore, set aside the order of the Commissioner of Income Tax (Appeals") and restored that of the Income Tax Officer, disallowing the claim made by the assessee. It is under these circumstances that the aforesaid two questions of law, arising out of the Tribunal's order, have been referred to this court for opinion.

Section 37 of the Income Tax Act, 1961, provides that any expenditure laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". Such expenditure, however, should not be in the nature of capital expenditure or personal expenses of the assessee. Any expenditure incurred by the assessee can, therefore, be claimed as an allowable deduction under the head "Profits and gains of business or profession", if the expenditure satisfies two tests : (i) that the expenditure laid out or expended is wholly and exclusively for the purposes of the business and/or profession, and (ii) that it is not in the nature of capital expenditure. That being so, it shall be necessary to always examine and explain the nature of the

expenditure incurred to be an allowable deduction to the assessee under the head "Profits and gains of business or profession" in terms of Section 37. In the present case, what is claimed is a payment to an erstwhile partner of a certain amount in lieu of his share of goodwill in the partnership when, in fact, despite such withdrawal of the partner, the partnership continues, accounts have not been settled between the outgoing partner and the remaining partners and the dues to the outgoing partner have not been ascertained and paid. Section 14 of the Partnership Act lays down that the "property of the firm" shall include the goodwill of the business. This, however, is subject to any contract between the partners. This when read with Sections 29 and 53 of the Act, gives a clear indication that the goodwill of a partnership firm is as much a property as any other property and has a value. This property can even be bought and sold (section 53 of the Partnership Act). Not only this, such goodwill can be transferred by gift and in that event is chargeable to gift-tax. In *Commissioner of Gift Tax, Gujarat Vs. Chhotalal Mohanlal*, there were three partners of a firm with seven annas, four annas and five annas share, respectively. One of the partners retired. Out of two remaining partners, the share of one was reduced from seven annas to four annas. A third partner was inducted with four annas share and two minor sons of the first partner were admitted to the benefits of the partnership, with a right to a share of 12% and 13%, respectively, in the profits. The question was whether there was a gift by the outgoing partner to his two minor sons under the Gift-tax Act, 1958. The Supreme Court, disagreeing with the decision of the High Court, held that there was a gift by the partner to his sons in respect of a part of the goodwill. In the course of the judgment, the Supreme Court referred to its earlier decision in *Khushal Khemgar Shah and Others Vs. Khorshed Banu Dadiba Boatwalla and Another*, wherein goodwill was held as an asset of a partnership firm. Referring to the two decisions in *Commissioner of Gift Tax Vs. Nani Gopal Mondal*, and *M.K. Kuppuraj Vs. Commissioner of Gift-tax*, the Supreme Court held that goodwill is property, that it has money value which can be transferred by gift and may be subject to gift-tax. In this state of law, it may be said without any hesitation that the share of Parmanandbhai in the goodwill of the partnership had money value which, on Parmanandbhai's withdrawal from partnership and on settlement of accounts, would have been paid to him. Instead, the arrangement made between Parmanandbhai and the remaining partners was to permit the partnership to have the full use of goodwill including Parmanandbhai's share therein and instead, to pay Rs. 50,000 per year in lieu of his share in that goodwill. It must, therefore, be held that this expenditure of Rs. 50,000 per year was incurred wholly and exclusively for the purposes of the business of the partnership.

It now remains to be determined whether the expenditure so incurred was a revenue expenditure or a capital expenditure. This question, as laid down by the Supreme Court, in *Devidas Vithaldas and Co. Vs. Commissioner of Income Tax, Bombay*, must depend upon the nature of the transaction itself. The majority view expressed therein (Sikri C. J. dissenting) is that it is not always easy to

distinguish whether an agreement is for the payment of price in stipulated instalments or for making annual payments in the nature of income. No single test of universal application can be laid down and the court has to look not only into the document relating to the transaction but also the surrounding circumstances to decide its true nature, the name which the parties give to it being of little consequence. If the parties have chosen to conceal, by a device, the true legal relation, it is open to the court to unravel such device and to ascertain the true nature of the relationship. Speaking about goodwill, the majority judgment says that acquisition of a goodwill of the business is, without doubt, acquisition of a capital asset, and, therefore, its purchase price would be capital expenditure, whether the price is paid in a lump sum or in instalments distributed over a definite period. Where, however, the transaction is not one for acquisition of the goodwill, but for the right to use it, the expenditure would be revenue expenditure. It is not the form but the substance of the transaction that matters. Similar view has been expressed by the Supreme Court in *Travancore Sugars and Chemicals Ltd. Vs. Commissioner of Income Tax, Kerala*, . In that case, on facts, the court found that the payment of a certain amount under the agreement was in the nature of revenue expenditure and not capital expenditure because (a) the payment was for an indefinite period and had no limitation of time attached to it ; (b) the payment was related to the annual profits which flowed from the trading activities of the appellant in that case and had no relation to the capital value of the assets ; and (c) the payment was not related to or tied up, in any way, to any fixed sum agreed between the parties as part of the purchase price of the three undertakings. Reference may also be made to a Division Bench decision of this court in *Commissioner of Income Tax Vs. M.B. Umbrella Industries*, . In that case, the assessee-firm had income from the business of manufacture of umbrellas. The firm paid Rs. 25,001 towards "TANK" trade mark commission to an old firm which was manufacturing umbrellas with that trade name. The two firms agreed that the assessee-firm may use the trade mark for five years on payment of Rs. 25,001 to the old firm per year. It was held that the amount so paid was not a price paid for acquisition of a capital asset, that the assessee-firm only acquired a licence to use the same formula as laid down in the agreement for a limited period of time on payment of a licence fee and that the payment of commission was in the nature of royalty on the trade mark used by the assessee. The expenditure was, therefore, held as revenue expenditure and was held as a deductible revenue expenditure. In the present case, from the facts, it is clear that the yearly payment of Rs. 50,000 in lieu of the use of the goodwill by the remaining partners of the firm would not amount to acquisition by purchase of Parmanandbhai's share in that goodwill. Instead, the arrangement for the time being was only to pay a certain amount periodically to enable the partnership to make use of that goodwill, the payment was for an indefinite period without any limitation of time and it had no relation to the capital value of the assets. The payment, in fact, was to allow continuance of the use of the goodwill.

It may be mentioned that when this case came up earlier for hearing before this court and was heard at some length, this court felt a necessity for calling for an additional statement from the Income Tax Appellate Tribunal. By order dated February 16, 1988, a supplementary statement was desired indicating whether Shri Parmanandbhai acquired any assets in partnership including its goodwill on the death of one of its partners, Smt. Jadavbai. The Tribunal made an additional statement and opined in the negative. That, in our opinion, may not matter much. Apparently, Parmanandbhai had a definite share in the partnership. He contributed Rs. 3 lakhs as share capital in the partnership. There is no agreement to the contrary that, on his retirement or on dissolution of the partnership, he would not get any share in the goodwill, when regarding Smt. Ujjambai, another partner, there was an express agreement that she would not be entitled to any amount of share on her retirement, on account of her share in the goodwill. That being so, even if Parmanandbhai did not inherit anything from the erstwhile partner Smt. Jadavbai, he had interest in all the assets of the partnership including goodwill.

The Income Tax Appellate Tribunal was not justified in observing that since Parmanandbhai did not contribute any thing towards the earning of the goodwill during his short tenure as partner of the firm, he cannot be held entitled to any share in the goodwill. The Tribunal is also not right in holding that Parmanandbhai left the firm for good. We fail to see any basis for the Tribunal's observation that the question of claiming any share in the goodwill of the firm by Shri Parmanandbhai Patel does not arise. There is no basis also for observing that the payment was made for any "extra-commercial considerations". It appears that, on facts, the Tribunal completely misdirected itself and the conclusion reached cannot be sustained. We, therefore, do not accept the contention advanced by learned, standing counsel for the Department that the Tribunal's conclusions are reached on findings of fact and, therefore, cannot be disturbed. Instead, our opinion is that the Tribunal failed to appreciate the circumstances and the real nature of the transaction and has also not applied the correct law applicable under the circumstances of the case.

In view of our aforesaid findings, we answer the aforesaid questions in favour of the assessee and against the Department and hold that the amount of Rs. 36,292 paid by the assessee-firm to Shri Parmanandbhai Patel was not prompted by any extra commercial-considerations. Instead, it was a revenue expenditure for purposes of the business of the firm and is allowable in computing the income of the assessee chargeable under the head "Profits and gains of business".

Reference answered accordingly. There shall be no order as to costs.