
(2003) 07 KL CK 0079

In the High Court Of Kerala

Case No : IT Ref. No's. 62 and 63 of 1998 and 89 of 2000

Nalini V. Saraf

APPELLANT

Vs

Controller of Estate Duty

RESPONDENT

Date of Decision : 18-07-2003

Acts Referred:

Estate Duty Act, 1953 — Section 5
Partnership Act, 1932 — Section 13

Citation : (2004) 188 CTR 169 : (2004) 268 ITR 223

Hon'ble Judges : S. Sankarasubban, J; K.K. Denesan, J

Bench : Division Bench

Advocate : S.E. Dastur, Pardiwallah, P. Balachandran and Preetha S. Nair, for the Appellant; P.K.R. Menon and George K. George, for the Respondent

Judgement

S. Shankarasubban, J.—Questions of law referred are as follows ;

"1. Whether, on the demise of the deceased did any property in the form of a share of the deceased in the accumulated profits and goodwill in the firm of Saraf Trading Corpn. pass in terms of Section 5 of the Estate Duty Act ?

2. If any property passed, was the Tribunal justified in determining the same at 10 per cent of the value or should the Tribunal have restricted it to Rs. 9,000?

3. Whether the profits arising to the firm upto the date of the demise should be considered in determining the quantum of accumulated profits ?

4. Whether, in determining the super-profits for the purpose of valuing the goodwill a deduction has to be allowed for interest on capital at 20 per cent as against 12 per cent allowed by the assessing authority ?

5. Whether, in determining the value of goodwill a multiplier of one year or three years has to be adopted ?

6. Whether any refund determined after the demise of the deceased could be regarded as property passing on the death of the deceased ?"

2. The facts of the case are as follows :

One V.G. Saraf passed away on 18th Oct., 1984. He was a partner in the firm, M/s Saraf Trading Corpn., a partnership firm carrying on business as commission agent and exporters of tea. The firm was originally constituted under the deed of partnership dt. 27th Nov., 1963, with three partners as follows:

(1) V.G. Saraf 50 per cent in profits & loss (2) A.V. Saraf 30 per cent --do-- (3) U.V. Saraf 20 per cent --do--

On 16th Sept., 1981, the partnership was reconstituted with the admission of one more partner and a minor. In valuing the interest of the deceased in the firm the Asstt. CED took the view that applying the provisions of Section 13(b) of the Partnership Act, the valuation should be on the basis of equal allocation of shares to the partners. He overruled the objection of the accountable person that the provisions of Section 13 of the Partnership Act were not attracted as Clause 7 of the partnership deed dt. 16th Sept., 1981 spelt out the manner and the method of distribution of the profit of the firm.

3. The Asstt. CED noticed that during the lifetime of the deceased, the firm had distributed a sum of Rs. 2,50,000 on 14th Nov., 1982, out of which Rs. 1,70,000 was given to the deceased, In the subsequent year, namely, year ended 4th Nov., 1983, in a distribution of Rs. 1,20,000 the deceased got a share of Rs. 30,000. It was noticed by the Asstt. CED that after the death of V.G. Saraf, a sum of Rs. 15 lakhs was distributed and in that only Rs. 9,000 was treated as the share of the deceased. Hence, he held that the profits of the firm were not distributed properly. He also noticed that the deceased was allowed to withdraw more than Rs. 10 lakhs during the same periods which resulted in a debit balance of Rs. 17,93,351 in his accounts at the time of death. The Asstt. CED came to the conclusion that the surviving partners had indulged in some kind of planning so as to avoid tax liability. In that view, he chose to adopt 1/5th share of the undistributed profits as the share of the deceased in the interest of the firm. He also took into account 1/5th share in the profit of the firm for the year ended on 24th Oct., 1984, on the ground that the time lag between the death and the closing of the accounts of the firm was short and that almost all the transactions of the firm must have been over as on the date of the death of the deceased. The Asstt. CED further held that even though the deceased was only a lessee of a building in which the business was carried on by the firm, the property commanded a market value and so he included the leasehold property for the purpose of estate duty assessment at 1/5th of its value. He also overruled the objection of the accountable person that the firm had no goodwill. In arriving at the value of the goodwill, he gave marginal reduction for managerial remuneration, etc. and computed the interest of the deceased at 1/5th of the value of the goodwill. In such computation, he included the amount of duty drawback, cash assistance, etc, which were received by the firm during the course of the business. Thus, 1/5th of the value of the goodwill was added as the share of the deceased.

4. The Appellate Controller upheld the finding of the Asstt. CED that the interest of the deceased in the firm was to be computed at 1/5th of the undistributed profits upto the date of death and the profit earned during the year upto the date of death. He also upheld the view that the assessee was entitled to a share in the goodwill notwithstanding the provisions of the partnership deed. He also held that for determining the value of the goodwill the multiplier of 3 was in order and that there was no other reason to interfere with the valuation. The Appellate Controller also upheld the inclusion of the refund of Income Tax and the interest u/s of the IT Act in the assets of the firm in determining the interest of the deceased.

5. The accountable person took up the matter in further appeal before the Tribunal. The Tribunal held that Section 13(b) of the Partnership Act was not applicable. It held that the determination of share is correct. It also held that the share of deceased was also at 10 per cent. An argument was raised before the Tribunal that the share will not be a property. But the Tribunal rejected that and held that the share of the deceased was property. Regarding profit in the year in which the accountable person died, it held that there was no accrual of the profit in the year in which the accountable person died. So far as the goodwill is concerned, it held that the deceased was entitled to goodwill. It reversed the finding of the Appellate Controller and held that the multiplier to be adopted is one and not three. So far as the refund and interest are concerned, it held that the refund is not property, which was inherited by the accountable person. So far as the average income is concerned, it allowed 20 per cent interest on the capital employed. The questions of law were referred to this Court by the Tribunal on the above facts and circumstances.

6. The crucial question to be considered in this case is what is the property which passed on the death of V.G. Saraf and what was the profits accrued to the deceased at the time of his death. As already stated, the partnership started in 1963. At that time the share of the deceased was fixed at 50 per cent in the profit and loss. So far as the partnership deed dt. 16th Sept., 1981, is concerned, in addition to the earlier partners, Dr. Asha V. Saraf was included and one minor was admitted to the benefits of the partnership. The duration of the firm was at will. So far as the division of profit is concerned, the relevant clause is Clause 7 of the partnership deed, which is as follows :

"7. The profits or lossess of the firm shall be determined at the end of accounting year and shall be divided between the partners and beneficiary only as hereinafter provided : --

(a) An amount not exceeding 10 per cent of the profits of the firm for the year shall be distributed among the partners and beneficiary every year, on such basis as may be agreed from year to year.

(b) In view of the nature of the present business, the balance of profits, remaining after distribution as above, shall be accumulated to absorb losses of

the firm and for other contingencies till such time as the partners decide otherwise, so however that at least 50 per cent of the accumulated profits of a year after setting off any brought forward loss shall be distributed among the partners and the beneficiary in any event before the expiry of three years from the date of accumulation. The partners do not have any specified or equal share in the accumulated profits and the partners shall decide the amount to be credited or debited as the case may be, to any one or to each partner at any time, giving weightage to the circumstances of the case. An outgoing or retiring partner shall have no share in the accumulated profits and on death, the estate of a deceased partner will get such share, if any, as the continuing partners shall decide.....

(d) On the dissolution of the firm, after paying all the liabilities of the firm and the amounts standing to the credit of the partners and minor the net surplus will be divided amongst the partners and the minor in such proportion as the partners may decide by majority."

Clause 10 states as follows :

"No partners of the firm shall be entitled to any specified share in the goodwill, if any, of the firm at any time and the goodwill shall continue to vest with the firm till all the properties of the firm are sold and realised."

Clause 11 states thus :

"In the event any partner retires or goes out from this partnership or expires, no part of the goodwill of the firm shall be considered and there shall be neither any claim nor shall anything be payable to such partner towards goodwill."

7. So far as the first question is concerned, the assessing authority held that Section 13(b) of the Partnership Act applies and hence all the partners share profits equally and the share was fixed at 20 per cent But as rightly stated by the Tribunal, Section 13(b) of the Act applies only when there is no contract to the contrary. A look at Clause 7 of the partnership deed would show that there is contract to the contrary. As to what share a partner will be entitled to is not specific. As a matter of fact, this question came up for interpretation in the decision in Commissioner of Income Tax Vs. Saraf Trading Corporation, . A Division Bench of this Court while interpreting this clause held as follows : "it was not the basis alone, but the factum of the agreement specifying share ratio in profits/losses that is necessary to exclude the right in share profits/losses equally. If upon scrutiny it was found that no contract specifying the share ratio in profits/losses was made after 16th Sept., 1981 to distribute profits/losses for the asst. yr. 1982-83, then Section 13(b) would apply. Neither the AO nor the appellate officer nor the Tribunal probed into the vital aspect whether the partners, in fact, made any agreement after 16th Sept., 1981, to specify share ratio in profits/losses. The question pertaining to the application of Section 13(b) of the Indian Partnership Act had to be remanded to the AO". Here we find that the profit has been declared and it was shown as Rs. 9,000. Hence, according to

us, Section 13(b) of the Partnership Act will not apply. The Tribunal was not correct in fixing the share at 10 per cent. The share of the deceased partner was Rs. 9,000 and that has to be taken into account.

8. The next question that has to be considered is as to how the profit is to be taken for the accounting year 1984. Saraf died on 18th Oct., 1984. At the time of his death, the accounting year was not over. The assessing authority as well as the appellate authority held that the profit for the entire year will pass on the death of Saraf. But as rightly pointed out by the Tribunal, at the time of death of the accountable person, the profits have not been declared. Hence, it cannot be said that any profit is accrued. Hence, we agree with the Tribunal.

9. The next question to be considered is with regard to the goodwill. So far as the goodwill is concerned, the Tribunal held that the deceased was entitled to share in the goodwill and held that it was property which passed on to the legal heirs. The Tribunal has given certain guidelines for calculating the goodwill; they are (1) to take only profit as disclosed in the books; (2) to allow deduction on the average profit at the rate of 20 per cent instead of 10 per cent; (3) to take multiplier of one instead of three years. It was held that 10 per cent of the share should be treated as share of the deceased in the goodwill. The argument of the learned counsel for the assessee was that the partnership itself says that on the death of the partner, the partnership will dissolve and that he will not be entitled to any goodwill. On the basis of this, it was held that no goodwill passed on the death of the deceased partner. In *S.C. Cambatta and Co. Private Ltd. Vs. Commissioner of Excess Profits Tax, Bombay*, the Supreme Court held as follows: "The goodwill of a business depends upon a variety of circumstances or a combination of them. The location, the service, the standing of the business, the honesty of those who run it and the lack of competition and many other factors go individually or together to make up the goodwill, though locality always plays a considerable part. Shift the locality, and the goodwill may be lost. At the same time, locality is not everything. The power to attract customer depends on one or more of the other factors as well. In the case of a theatre or restaurant, what is catered, how the service is run and what the competition is, contribute also to the goodwill".

10. As we have already stated, the argument of the learned counsel for the assessee was that since the partnership deed stated that on the death of a partner, the firm will have to be dissolved and that the partner shall have no right in goodwill. A similar case came before the Supreme Court in *Controller of Estate Duty, Gujarat-I, Ahmedabad Vs. Smt. Mrudula Nareshchandra*, wherein the Supreme Court negated the contention and held that the deceased was entitled to goodwill. It held as follows: "In the aforesaid view of the matter, we are of the opinion that the share of the deceased in the partnership did not evaporate or disappear. It went together with the other assets and should be valued in the manner contemplated under r. 7(c) of the ED Rules...". In the calculation of the goodwill, the Tribunal has taken into account the

circumstances, which cannot be said to be not relevant and it was in the above circumstances that it fixed the value at 20 per cent and also given the multiplier at one. In *Smt. Vindoor Bai Vs. Controller of Estate Duty*, , it was held as follows ; "Under the ED Act, each and every right which passes on death has to be valued. The evaluation has to be done on the basis of the assumption that there is a willing purchaser for the right or property. In this evaluation, it would not be proper to find out whether the right or article left by itself is capable of earning money. It is the settled practice to value goodwill for estate duty and the methods adopted are not unreal or imaginary". It further held as follows : "In this country, the method of evaluating goodwill is to find out the net average profit after deducting interest on the capital outlay and the appropriate cost of service, in case it has not been charged against the net profits. After having determined this, a reasonable return on the capital employed is calculated, and the excess amount of profits is taken to be the super-profits. This amount is multiplied by a certain number of years, and the resultant figure is taken to be the value of the goodwill. There does not appear to be any hard and fast rule regarding the multiple to be applied for evaluating the goodwill of a firm. It all depends on the nature of the business and the prevailing market circumstances".

In *M.M.N.D. Muthiah Rajasabai v. CED* (1999) 240 ITR 65, a Division Bench of this Court held as follows: "that in any business of substantial proportions one of the two methods, i.e., (a) superprofits method; and (b) total capitalisation method is used to compute the value of the goodwill. Both the methods are aimed at estimating the profitable amount of the future profits. The method of computation involves working out the average profits for the first method. Since the conclusion was essentially on the facts, no question of law arose. What could be the appropriate multiplier to be adopted would depend on the facts and circumstances of each case and no hard and fast rule can be laid down. The Tribunal upheld the application of the three times multiplier taken by the authorities below. While doing so, the Tribunal noticed that the lower authorities had given reasons for arriving at the figure and that was how the Tribunal conducted in the facts about the reasonableness of the multiplier adopted. This was a finding of fact which could not be interfered with".

11. In this case, we find that the Tribunal has given certain facts and on that basis it has come to the conclusion of adopting multiplier at one. Hence, we are of the view that it is a pure question of fact and does not call for interference by this Court.

12. The next question is whether the refund determined after the demise of the deceased could be passed on the death of the deceased. So far as this matter is concerned, even though many decisions were cited, there is a Division Bench decision in *CONTROLLER OF ESTATE DUTY Vs. H. H. SETHU PARVATHI BAI (ESTATE OF LATE) BY H. H. LAKSHMI BAI.*, , wherein this Court held as follows : "The mere right to claim refund which might or might not materialise is not property within the meaning of Section 2(15) of the ED Act, 1953. Unless it is

possible to say that there was some amount due by way of refund as of right at the time of the death, it would not be property under the Act".

In the above view of the matter, we hold that the right to refund is not property and did not pass on the death of the deceased.

13. In the above view of the matter, we answer the questions as follows :

Question No. 1 is answered in the positive in favour of the Department. We answer question No. 2 that the Tribunal should have restricted the profit to Rs. 9,000. Question No. 3 is answered in the negative in favour of the assessee. Question No. 4 is answered in the positive in favour of the assessee. Question No. 5 is answered in favour of the assessee and against the Department. Question No. 6 is answered in favour of the assessee and against the Department.