
(1987) 12 KL CK 0019
In the High Court Of Kerala
Case No : Income Tax R. No. 21 of 1982

Parthas Trust

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 09-12-1987

Acts Referred:

Income Tax Act, 1961 — Section 32, 45, 48

Citation : (1988) 68 CTR 1 : (1988) 173 ITR 615

Hon'ble Judges : T. Kochu Thommen, J; K.P. Radhakrishna Menon, J

Bench : Division Bench

Advocate : G. Sivarajan and M.P. Vinod, for the Appellant; P.K.R. Menon, for the Respondent

Judgement

T. Kochu Thommen, J.—The following two questions have been, at the instance of the assessee, referred to us by the Income Tax Appellate Tribunal, Cochin Bench :

" 1. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the surplus realised on the sale of goodwill of the Changanacherry business of the assessee acquired by the assessee at a cost is to be assessed as capital gains u/s 45 in the light of the decision of the Supreme Court in Commissioner of Income Tax, Bangalore Vs. B.C. Srinivasa Setty,

2. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the assessee is not entitled to depreciation on the immovable property which has not been transferred to the assessee by the previous owner by a registered deed of conveyance ? "

2. We answer question No. 2, in the light of the decision of the Full Bench of this court in Parthas Trust Vs. Commissioner of Income Tax, , in the affirmative, that is, against the assessee and in favour of the Revenue.

3. Question No. 1 relates to the sale of goodwill arising from the transfer of assets effected by the assessee in the accounting year previous to the assessment year 1976-77. The assessee's books of account disclosed that the

assets of its business included the goodwill purchased by the assessee in 1971, and the value of the goodwill in relation to the business at Changanacherry and Kottayam was specifically shown as Rs. 90,000. The cost of acquisition of the goodwill relating to the Changanacherry business, which alone is in question here, was determined by the Tribunal to be the proportionate part of Rs. 90,000 which was directed to be computed by the concerned officer. The books of account for the year relevant to the assessment year in question disclosed that the assessee transferred the assets of the Changanacherry business to a certain firm and the goodwill of that business was valued at Rs. 1,00,000.

4. The Income Tax Officer, however, found that the goodwill was sold for Rs. 2,00,000. This finding was without regard to the case of the assessee that Rs. 2,00,000 represented the goodwill of the transferred business at Changanacherry and Ernakulam, and that only Rs. 1,00,000 represented the consideration of the goodwill of the Changanacherry business. On the basis of this assumption, the Income Tax Officer held that the difference between the sale price at Rs. 2,00,000 and the cost of acquisition at Rs. 90,000, that is. Rs. 1,10,000, was liable to be included as the capital gains of the assessee arising from the transfer of the Changanacherry business (see annexure A).

5. On appeal by the assessee, the Commissioner of Income Tax (Appeals), relying on the decision of the Full Bench of this court in Commissioner of Income Tax Vs. E.C. Jacob, and certain other decisions, held that :

" ... the inclusion of Rs. 1,10,000 as income falling under the head " Capital gains " was unjustified on facts and in law. " (see annexure B).

6. This decision was, on appeal by the Revenue, reversed by the Tribunal. On behalf of the assessee, it was contended before the Tribunal that, in the light of the decision of the Supreme Court in Commissioner of Income Tax, Bangalore Vs. B.C. Srinivasa Setty, , the provisions relating to capital gains were not applicable to the value of the goodwill realised on the sale of a business. Rejecting that contention and distinguishing the facts of the case from those which arose in Commissioner of Income Tax, Bangalore Vs. B.C. Srinivasa Setty, , the Tribunal held that the goodwill transferred by the assessee was not self-created goodwill, but goodwill which it had purchased when the transferred business was earlier acquired by the assessee in 1971 and the cost of acquisition was clearly recorded in the books of account. In the circumstances, the Tribunal found that the difficulty pointed out by the Supreme Court in the computation of capital gains in respect of a new business which had self-generated the goodwill was not present in the case of the assessee.

7. The fundamental question is whether or not, in respect of gains arising from the transfer by the assessee of goodwill, which the assessee had purchased prior to the transfer, are attracted by the provisions relating to capital gains so as to bring to tax such gains. It is not disputed that the cost incurred by the assessee in acquiring the assets of the business in question in 1971, including that of the

goodwill, had been clearly recorded in the books of account, and the proportionate cost of the goodwill of the Changanacherry business is easily ascertainable. It is no longer disputed either by the Revenue or by the assessee that the sale price of the goodwill of the Changanacherry business was Rs. 1,00,000, The difference between the sale price and the proportionate cost price of the goodwill, according to the Revenue and as found by the Tribunal, represents the capital gains chargeable to tax u/s 45.

8. Appearing for the assessee, Shri M. P. Vinod, submits that the Supreme Court has clearly stated in Commissioner of Income Tax, Bangalore Vs. B.C. Srinivasa Setty, , that the computation provisions relating to the charge u/s 45 of the Income Tax Act, 1961, are inapplicable to goodwill and, therefore, the goodwill in question is not amenable to be charged u/s 45. Counsel further relies upon the decision of the Bombay High Court in Evans Fraser and Co. Ltd. (In Liquidation) Vs. Commissioner of Income Tax, Bombay City-II, and submits that, in respect of goodwill, the computation mentioned u/s 48 in relation to the cost of improvement is unworkable, for such cost is indeterminable, and the charge u/s 45 can have no application to such capital asset.

9. It must be noticed that the Supreme Court dealt with a newly started business in the sense that the business in question was started for the first time by the assessee and the goodwill generated by it was, therefore, not the goodwill which it had purchased. It was what was referred to as a self-generated or self-created goodwill, the commencement of which or the cost of acquisition of which was indeterminable. The court held that capital gains arose to the extent to which the sale price exceeded the cost price. The cost of acquisition was, therefore, an essential component in the computation of capital gains. So was the time of commencement of the goodwill. In the absence of these components, there was no way to determine the gains arising from the sale price received by the transferor. The court then said that the charge u/s 45 could not work except with the aid of the computation provisions contained in the Act and, where the computation was not possible, in the absence of any method to determine the cost and the date of acquisition of the self-generated goodwill of a newly started business, Section 45 was inapplicable and no part of the sale proceeds could be brought to tax as capital gains. This is what the Supreme Court stated (p. 300 of 128 ITR) :

" None of the provisions pertaining to the head " Capital gains " suggests that they include an asset in the acquisition of which no cost at all can be conceived...In the case of goodwill generated in a new business, there is the further circumstance that it is not possible to determine the date when it comes into existence. "

10. This is all that the Supreme Court stated in the aforesaid decision. The reasoning of the court, however, indicates that, in a case where the goodwill was not self-generated, but purchased from the previous owner of the business for known consideration, and on a known date, as disclosed by the books of account,

there was no difficulty in computing the gains arising from the subsequent sale of the business by the assessee and bringing to tax under the head " Capital gains " the portion of the sale proceeds representing the value of the goodwill.

11. The Supreme Court confirmed the decision of the Full Bench of this court in Commissioner of Income Tax Vs. E.C. Jacob, . That was also a case which related to the transfer of a newly started business and the goodwill in question there was a self-generated asset. Nevertheless, this court had significantly noticed the difference between the incidence of sale of the goodwill of such a business and that of a business which had been earlier purchased by the assessee and subsequently sold by him. This court stated (p. 93) :

" It is possible to envisage a case where a person purchases the goodwill of a business or profession for a definite amount and without any further addition to its value by his own efforts later on sells it for a higher price and thereby secures a determinate profit or gain. In such a case, goodwill is hardly distinguishable from any other capital asset and there is nothing in Section 45 or other relevant provisions of the Income Tax Act that excludes such profits or gains from liability to assessment. "

12. Section 45 reads :

"45. Capital gains.--(1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 53, 54, 54B, 54D, 54E and 54F, be chargeable to Income Tax under the head " Capital gains ", and shall be deemed to be the income of the previous year in which the transfer took place. "

13. Section 48 which provides for the computation of the capital gains says :

" 48. Mode of computation and deductions.--The income chargeable under the head " Capital gains " shall be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely :--

- (i) expenditure incurred wholly and exclusively in connection with such transfer ;
- (ii) the cost of acquisition of the capital asset and the cost of any improvement thereto.

This section postulates that in the computation of the income chargeable under the head " Capital gains ", as provided u/s 45, the amounts falling under clauses (i) and (ii) of Section 48 shall be deducted from the full value of the consideration received. One of the items thus deductible is the cost of acquisition of the capital asset. As stated by the Supreme Court, this is an essential component with reference to which alone can the gains be determined. In the absence of any information on that component, the entire sale proceeds would have to be brought to tax as capital gains, and the court was not willing to put such a construction on the section. To get over the difficulty arising from the

construction adopted by the court, the Act was amended by the Legislature with effect from April 1, 1988, as a result of which there would be no difficulty in the future even when the cost of acquisition was unknown, for it would then have to be taken to be nil. The amendment further provides that the cost of improvement in all cases shall be taken to be nil. But if the cost and date of acquisition are known, as in the present case, the fact that the assessee has not claimed any expenditure incurred by him wholly and exclusively in connection with the transfer of his business, as postulated under clause (i), or the cost of any improvement to the asset in question, mentioned in clause (ii), does not mean that the gains arising from the transfer cannot be computed. These components representing the deductible expenditure in connection with the transfer of the cost of improvement, unlike the cost and date of acquisition, are not essential for the computation of the gains, but are only enabling provisions for the assessee to claim deduction from the sale price so as to reduce the chargeable gains which have arisen. By refusing to claim any such deduction, no assessee can defeat the operation of Section 45. In the present case, there is no claim for expenditure in connection with the transfer or for the cost of any improvement to the assets in question.

Disagreeing with the assessee's counsel who submits that the cost of improvement in relation to goodwill cannot be computed, Shri Sudeer Gopi, to whom we are indebted for the valuable help rendered as *amicus curiae*, submits that the principles of accountancy are no longer what they were when the courts regarded that the cost of improvement in relation to goodwill could not be computed. He submits that such cost is now determinable.

What one should ask in the present case is not whether the cost of improvement is determinable, but whether the assessee has claimed any cost and whether it has been disallowed. Since the assessee has not claimed any expenditure or cost, it is unnecessary to enquire whether these two elements mentioned under clauses (i) and (ii) of Section 48 are capable of determination in relation to goodwill. But what is significant is that the computation of capital gains u/s 48 presents no difficulty even when the assessee has not claimed any deduction by way of expenditure under Clause (i) or cost of improvement under clause (ii), so long as the cost and time of acquisition are known components. With great respect, we do not agree with the observation of the Bombay High Court to the contrary in *Evans Fraser and Co. Ltd. (In Liquidation) Vs. Commissioner of Income Tax, Bombay City-II*, .

In the present case, as stated earlier, the cost of acquisition is easily determinable. The Tribunal has, by its order, directed the concerned officer to compute the proportionate cost of acquisition of the goodwill subsequently transferred by the assessee in respect of his Changanacherry business. In the absence of any claim for expenditure in connection with the transfer of the goodwill or cost of any improvement thereto, the entire difference between the sale proceeds representing goodwill, as shown in the books, and the

proportionate cost of acquisition of that goodwill would represent the income chargeable under the head " Capital gains ".

14. Counsel for the Revenue submits that the amendments to the relevant provisions which came into effect on April 1, 1988, are clarificatory of the law as it always has been and should be regarded as applicable at all material times, and, where the cost of acquisition was unknown, it should be taken to be nil, and the capital gains computed accordingly. Likewise, the cost of improvement, he says, must in all cases be taken to be nil. This is a matter which does not arise from the present question, and we express no view upon it.

15. Accordingly, we answer question No. 1 in the affirmative, that is, in favour of the Revenue and against the assessee.

16. We direct the parties to bear their respective costs in this tax referred case.

17. A copy of this judgment under the seal of the High Court and the signature of the Registrar shall be forwarded to the Income Tax Appellate Tribunal, Cochin Bench.