
(1982) 08 P&H CK 0052

In the Punjab And Haryana At Chandigarh

Case No : Income-tax Reference No's. 39, 40 and 48 of 1976

Sukhbir Parshad

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 13-08-1982

Acts Referred:

Income Tax Act, 1961 — Section 256(1)

Citation : (1983) 33 CTR 83 : (1983) 144 ITR 437

Hon'ble Judges : S.S. Sandhawalia, C.J.; S.P. Goyal, J

Bench : Division Bench

Advocate : B.K. Bhargava, S.P. Jain and V.K. Jain, for the Appellant; Ashok Bhan and Ajay Kumar Mittal, for the Respondent

Judgement

S.P. Goyal, J.—This judgment will dispose of three Income Tax References Nos. 39, 40 and 48 of 1976, as the decision of the questions referred in all of them are inter-dependant.

2. The assessment year in all the three references is 1967-68, and the facts involved which are common in all of them are that 8 persons, (1) Kirat Chand Jain, (2) Jaini Lal Jain, (3) Mahabir Parshad, (4) Jai Prashad Jain (5) Darshan Lal Jain, (6) Sukhbir Parshad, (7) Trilok Chand Jain, and (8) Phool Chand were carrying on business at Jagadhri in the name of two partnership firms, that is, M/s. Kewal Ram Uggar Sain Jain and M/s. Swastiga Metal Works. Four at its partners, Kirat Chand, Mahabir Prashad, Sukhbir Parshad and Phool Chand retired from the partnership on January 19, 1967, on the terms and conditions contained in the written memorandum dated January 28, 1967, which was written between the outgoing partners, continuing partners and incoming partners, namely, Moti Lal, Nem Chand, Janki Devi and Jinendra Kumar Jain. The relevant clauses for the purpose of these references are as under:

"1. That the retiring partners had accepted the statement of accounts prepared as on the 19th day of January, 1967, in the books of account of the firm as true and correct and each of the retiring partners had also accepted the accounts

lying in the credit or debit of his respective accounts as on 19-1-1967 as true and correct.

2. That each of the retiring partners had received or had paid according to the credit or the debit balance lying in his respective account as shown in the statement of accounts prepared as on 19-1-1967, referred to above.

3. That the retiring partners received Rs. 10 lakhs only in proportion to their respective shares in the old firm as lump sum consideration in full and final settlement of the transfer of the goodwill, quota rights, quota entitlements and all other rights, titles, and interest in the movable and immovable properties of the old firm comprising of the stock-in-trade, materials, book debts, contracts, effects used in the business or belonging to the old firm (as specified in the schedule attached to this memorandum), in favour of the reconstituted firm and with effect from 20th January, 1967, the reconstituted firm became absolute and irrevocable owner of all the movable and immovable properties, titles, rights and interests in the properties of the old firm as specified in the Schedule. It was specifically agreed to between the partners that machinery, plant, furniture, lands and buildings were transferred at their written down value.

7. That the retiring partners agreed that with effect from 20th January, 1967, the reconstituted firm became entitled to recover all money due to the old firm and the reconstituted firm also became entitled to the benefit of all the executed and unexecuted contracts, all existing and future quota rights, entitlements, trade marks, ISI mark, import licences and industrial licences, etc., of the old firm.

8. That retiring partners also agreed not to carry on any business in the same trade name and style, i. e., M/s. Kawal Ram Uggar Sain Jain, Jagadhri and Swastika Metal Works, Jagadhri. They further agreed not to use the trade mark particularly the emblem "Swastika" as used by the old firm which exclusively vested in the reconstituted firm as its property."

3. The new firms furnished its returns for the accounting year from April 1, 1966, to March 31, 1967, and claimed Rs. 10 lakhs paid to the outgoing partners as a revenue expense contending that the same had been paid in consideration of the purchase of quota rights and its entitlement. The assessing authority turned down the plea holding that the payment was in consideration of an enduring benefit and as such was not revenue expense. The appeal by the assessee was also dismissed by the AAC but slightly with a different finding that the amount of Rs. 10 lakhs was paid to the outgoing partners in lieu of their shares in the assets of the firm, The view of the AAC was confirmed by the Tribunal, vide its judgment dated January 24, 1974. But on the application u/s 256(1) of the I.T. Act by the assessee, the following questions have been referred to this court:

"1. Whether, on the facts and circumstances of the case, the Tribunal was right in restricting the claim of the assessee to Rs. 10,00,000 as a whole and in not going into the question whether any part of it was allowable as a revenue expense ?

(2) Whether, on the facts and circumstances of the case, the Tribunal was right in holding that there is no material on the record on the basis of which it may be possible to split up the quantum of compensation in respect of each of the various items ?

(3) Whether, on the facts and circumstances of the case and on the construction of (i) partnership deed dated January 20, 1967 (annexure A), (ii) memorandum dated January 28, 1967 (Annexure C), and (iii) account book entries, the Tribunal was right in holding that the payment of Rs. 10,00,000 or any part thereof was not a revenue expense allowable to the assessee-firm?"

4. However, at the time of the hearing, no arguments were addressed on questions Nos. 1 and 2 by the learned counsel for the assessee and the same are accordingly answered in favour of the Revenue and against the firm.

5. Two of the outgoing partners, Sarvshri Mahabir Parshad and Satbir Parshad, who received Rs. 2,50,000 and Rs. 1,87,500 respectively, claimed before the assessing authority that the same had been received on account of their share of the capital and as such was not a revenue receipt. The assessing authority repelled their contentions but allowed the amount of Rs. 50,000 and Rs. 37,500 respectively on account of the price of goodwill which according to him was a capital asset. The rest of the amount of Rs. 2,00,000 and 1,50,000 was treated in their hands as revenue receipt. The order of the assessing authority was reversed by the AAC but restored by the Tribunal, vide judgment dated June 5, 1975, which led to the referring of the following two questions which are subject-matter of ITR Nos. 39 and 40 of 1976, respectively :

I.T.R. No. 39 of 1976:

"Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was justified in law in holding that a sum of Rs. 1,50,000 is a business receipt and as such includible in the computation of the assessee's income ?" LT.R. No. 40 of 1976 :

Whether, on the facts and in the circumstances of the case, was the Income Tax Appellate Tribunal justified in law in holding that a sum of Rs. 2,00,000 is a business receipt and as such includible in the computation of the assessee's income ?"

6. The case initially came up for hearing before a Division Bench consisting of B. S. Dhillon J. and myself and vide order dated March 21, 1980 we called for a supplementary statement on the following points :

(1) Did the compensation paid to the outgoing partners relate to the capital assets? If so, what is the amount of compensation payable in that regard ?

(2) Did the compensation also represent the capitalised profit ? If so, what is the amount of compensation payable in that regard ?

7. The Tribunal, however, sent back the case showing its inability to send a

supplementary statement of the case, as according to it, it involved a fresh investigation into facts which was not permissible under law. We are constrained to observe that the Tribunal has out-stepped its jurisdiction and instead of performing its duty has tried to tell this court as to what is the law on the subject. The view of the Tribunal that a submitting of the supplementary statement would involve fresh investigation is wholly unjustified and there was sufficient material on the record which would be referred to later on to give its opinion on the two points referred to it. Still, we do not propose to make another reference to the Tribunal and will answer the questions by reference to the material which forms part of the statement of the case already submitted.

8. The amount of Rs. 10,00,000 was paid to the outgoing partners on their retirement from partnership. The amount could be ascribed either wholly to their share of the capital assets or to the estimated profits because of the increase in the market price of the raw material already received and the value of quota rights or on both counts in which case it may have further to be determined as to what part of the amount was paid on account of capital assets and what part on account of the estimated profits and quota rights. But in either case the nature of the amount paid would be the same qua both the parties and it cannot be that it may be a capital expenditure on the part of one party but a revenue receipt in the hands of the other party. Though, as held in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, , it is not universally a true proposition that what may be a capital receipt in the hands of a payee must necessarily be a capital expenditure in relation to the payer. But in the case of the payment made to a retiring partner by the continuing partners, it passes our comprehension if, under any circumstance, the amount paid can have two different characteristics qua the two parties. So we are of the considered view that on the present facts and circumstances if the entire amount of Rs. 10,00,000 received by the retiring partners was a revenue receipt it would certainly be a revenue expense on the part of the continuing firm and vice versa.

9. For holding the amount in the hands of the retiring partners as revenue receipt, the Tribunal relied on the Supreme Court decision in *The Commissioner of Income Tax, U.P., Lucknow Vs. Gangadhar Baijnath Generalganj, Kanpur*, , but that was a wholly misplaced reliance. In that case two independent entities described as the Bagla Group and the Jaipuria Group respectively were engaged in the business of managing agencies. They both entered into a partnership to take over managing agency of Swadeshi Cotton Co. Ltd. The contract entered into between them was later on cancelled and the Bagla Group surrendered their rights in the managing agency on receipt of Rs. 35,01,000. On these facts it was held that it was not a case of parting with any agency rights and, in reality, was a case of cancellation of contract which had been entered into in the ordinary course of business. Relying on *Commissioner of Income Tax, Nagpur Vs. Rai Bahadur Jairam Valji and Others*, , it was ruled that the amount received was in the nature of a revenue receipt. Obviously, the facts in *The Commissioner of Income Tax, U.P., Lucknow Vs. Gangadhar Baijnath Generalganj, Kanpur*, , are

quite distinguishable from the present case. Here the partnership which was dissolved was constituted in the year 1951 for the manufacture of certain non-ferrous items which continued for a period of about 16 years. The dissolution of the partnership by no stretch of reasoning can be said to be a cancellation of any contract entered into for a particular enterprise in the usual course of business already being carried on by the retiring partners. The basis for the view of the Tribunal thus being not sustainable, we have to determine the true nature of the amounts received by the retiring partners on the basis of the facts stated in the statement of the case.

10. In the case of the said firms, the Tribunal held that the amount was paid to the retiring partners for the estimated agreed value of the 50 per cent. of the realizable surplus of the firm's assets and liabilities and hence was in the nature of capital expenditure. The Tribunal, though it accepted the alternative argument of the assessee that the amount was paid by them on account of the share of the retiring partner in the capital assets as well as the share of future profits and quota rights, refused to apportion the same because the assessee had failed to do it himself and to produce any material from which it could be so done. None of the two reasons given are sustainable and, in fact, they run counter to the material available on the record. The assessee all through had been asserting on the basis of the balance-sheet of the two firms, annexs. D and E, and the chart, annex. G, showing the book value, market value, written down value and their different closing stock, building, machinery, trucks, vehicles, and in pending import application, import licence that the whole of the amount of Rs. 10,00,000 had been paid on account of the difference in the market value of the closing stock of the raw material and the estimated future profits. These documents and the other annexures containing the details of the trading account were conveniently ignored by the assessing authorities and instead it was erroneously observed that the assessee, had failed to specify as to on what account the payment of Rs. 10,00,000 had been paid and apportion the same in case it was paid by them on account of capital assets as well as the increase in the market price of the stock-in-hand and the future profits on import licences and quota rights.

11. According to cls. 2 and 3 of the memorandum, annex. C, the machinery, plant, furniture, lands and buildings were transferred at the written down value and each of the retiring partner had received or was paid according to the credit or debit balance lying in his account prepared on January 19, 1967. From the perusal of the balance-sheet of the two firms, annexs. D and E, it is evident that there was hardly any credit balance available for distribution amongst the partners which leads to the irresistible conclusion that the amount of Rs. 10,00,000 could not be referable to any share of the retiring partners in the capital assets of the firm. It is further clear from the chart, annex. G, showing the book value, market value and written down value of the various assets of the firm that the stock in hand was transferred at the book value of Rs. 13,43,315.19 whereas its market value was Rs. 29,44,993.69, The future profits from the

pending import applications and import licences were estimated at Rs. 6,00,000. Apart from these items, the most valuable right, which was surrendered was the share in the quota rights. There can be hardly any two opinions that anything paid on account of the difference of the market value and the book value of the existing stocks and the estimated future profits, pending import applications and import licences would be a revenue expenditure, the same having been paid for the purpose of the business of the firm. As regards the amount paid on account of the purchase of the share in the quota rights, the matter stands concluded by the decision of the Supreme Court in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, as would be evident from the following observations (p. 12):

"Take a case where acquisition of raw material is regulated by quota system and in order to obtain more raw material the assessee purchases the quota right of another. Now, it is obvious that by purchase of such quota right, the assessee would be able to acquire more raw material and that would increase the profitability of his profit-making apparatus, but the amount paid for purchase of such quota right would indubitably be revenue expenditure, since it is incurred for acquiring raw material and is part of the operating cost."

12. The same analogy would apply to the surrender of the rights in the import licence and anything paid on its account would equally be a revenue expenditure. No part of the amount of Rs. 10,00,000 was thus paid to the retiring partners for acquiring their share in any capital asset of enduring benefit and had instead been paid for the purposes of the business on account of the estimated profits on the raw material already in stock but transferred on its book value or to be acquired against the quota rights and the import licence of the firm which continued to exist though with different constitution. The test to determine the nature of the expenditure was recently laid down by the Supreme Court in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, in the following terms (p. 80):

"What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future."

13. When this test is applied to the facts and the findings recorded above, we have no option but to hold that the amount paid was revenue and not capital expenditure.

14. Now we may deal with the decisions relied on by the learned counsel for the Revenue in support of his contention that any payment made to the retiring partners would necessarily be in the nature of a capital expenditure. The nearest

case relied upon by the learned counsel is of Delhi High Court in General Auto Parts Co. Vs. Commissioner of Income Tax, , wherein the amount of Rs. 1,00,000 was paid to the two retiring partners in lieu of their interest in all the assets, goodwill, quota rights of imports and exports and licences previously held by the dissolved partnership. However, in the cash book of the firm which was signed by all the partners, the amount of Rs. 1,00,000 was split up into two components; the sum of Rs. 48,076.15 was ascribed to the goodwill of the firm and the balance stated to represent the amount of appreciation in the value of the stocks and licences. Apart from this amount of Rs. 1,00,000, whatever Was lying to the credit of the two partners in the account books of the firm on account of their share capital was also paid to them, The assessee accepted and did not dispute that the amount shown as paid on account of the goodwill to the retiring partners was a capital expenditure and the controversy was confined to the remaining sum of Rs. 51,923.85. The contention of the assessee that the amount spent was revenue expenditure was rejected on the following reasoning (p. 525):

"No doubt on the date of the retirement the amounts mentioned in Clause 1 were the only amounts standing to the credit of the partners in their capital account. But apparently the parties were of opinion that this did not represent the entirety of the value of their interests. The language of Clause 2 clearly shows that the sum of Rs. 1 lakh mentioned in that clause has been made by way of consideration for the relin-quishment by the retiring partners in favour of the continuing partners of any rights that they may have in respect of various assets of the firm. The fact that some of these assets are mentioned by specific reference does not mean that the payment was intended to be made for the use of these assets. The reference to import licences, quota licences, cars and telephones, are only to emphasise that the retiring partners were giving up all their rights, title and interest in the firm in consideration of the payment of the sum of Rs. 1 lakh."

15. From a bare perusal of the above observation, it is apparent that the Bench proceeded on the basis that the amount paid on account of share capital did not represent the entire value of the interest of the retiring partners. There was, however, no basis for this observation because both the parties had accepted the correctness of the accounts and the balance-sheet showing the assets and liabilities of the dissolved firm. A further observation that the amount of Rs. 1 lakh was paid towards various assets of the firm was equally conjectural because there was nothing before the court to go beyond the balance-sheet which was accepted to be correct between the four partners. There can be no dispute if the retiring partners are paid any sum on account of their share in the capital assets of the firm it would certainly be a capital expenditure. But, if the amount is paid on account of the estimated profits to be derived from any stock-in-hand or quota rights or import licence it would a revenue receipt in the hands of the retiring partners and correspondingly a revenue expenditure on the part of the continuing firm. With utmost respect to the learned judges, we are, therefore, unable to follow this decision.

16. The next case relied upon is Chhotubhai Gopalbhai Patel Vs. Commissioner of Income Tax, Bombay, . In this case B retired from the partnership and surrendered his 1/4th share on receipt of Rs. 15,000 from A. The assessee joined the partnership with A and his sons and paid Rs. 15,000 towards his share of the capital. The assessee claimed to deduct this amount as having been laid out or expended for the purpose of the business. It was held that the amount was not paid to the outgoing partner but was paid to A in order to secure 1/4th share in the business of the firm and, therefore, could not be treated as business expenditure. Obviously, this case has no bearing on the present case. Similarly in V. RANGASWAMI NAIDU Vs. COMMISSIONER OF Income Tax, MADRAS., and Rao Bahadur R. Guruswamy Naidu Udumalpet Vs. The Commissioner of Income Tax, Madras, , it was the share in the assets of the firm which was purchased and so the amount spent was held to be a capital expenditure. There can be no dispute with the proposition laid down in these decisions but here as already held the amount was paid not to acquire the share of the partners in the firm but in lieu of the estimated profits on account of the increase in the price of the stock-in-hand which otherwise stood transferred on their book value and the benefits likely to accrue from quota rights and the import licences. R. S. RADHA KISHAN KAPOOR Vs. COMMISSIONER OF Income Tax, U. P. and V. P., , again has different facts and apart from that, it runs counter to the decision of the Supreme Court in The Commissioner of Income Tax, U.P., Lucknow Vs. Gangadhar Baijnath Generalganj, Kanpur, . The last case on this point relied upon by the learned counsel is a Division Bench decision of the Lahore High Court in (1945) 13 ITR 430 . In that case certain amount was paid against five years' profit to a partner of the firm and the other partners were allowed to run the business for that period exclusively for their benefit. The contention of the assessee that the amount had been spent for business expense was rejected on the ground that it was paid in order to acquire the right to conduct business and not for the purpose of producing profits in the conduct of the business. Obviously, the facts being totally different, this case is also of no help to the Revenue.

17. It was next contended that in any case the amount which was paid for the acquisition of goodwill would be a capital expenditure, the goodwill being a capital asset. Reliance for this proposition was placed on Devidas Vithaldas and Co. Vs. Commissioner of Income Tax , Bombay, and S. Kuppaswami Vs. Commr. of Income Tax, Madras, . According to the terms settled between the retiring partners and the continuing partners, the firms were not dissolved and the continuing partners were entitled to carry on business in the firms' names. What was done was that the retiring partners were restrained from setting up any business in the name of the said firms. There was thus no acquisition of any goodwill by the continuing firms and no part of the amount paid could thus be ascribed towards the purchase of any goodwill.

18. In view of the foregoing discussion, the two questions in ITR No. 39 and 40 of 1976 are answered in the affirmative, in favour of the Revenue and against the assessee, whereas question No. 3 in ITR No. 48 of 1976, is answered in the

negative, in favour of the assessee and against the Revenue. Keeping in view the circumstances of the case, we make no order as to costs.

Sandhawalia, C. J.

19. I agree.