

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION**

INCOME TAX REFERENCE NO. 225 OF 1999

Jamnalal Sons Ltd.
Bajaj Bhavan, Nariman Point,
Bombay – 400 021

.. Applicant

v/s.

The Commissioner of Income Tax
City V, Vidarbha, Nagpur

.. Respondent

Mr. J.D. Mistri, Senior Counsel i/b Ms. V.B. Patel for the applicant
None for the respondent

**CORAM : M.S. SANKLECHA &
S.C. GUPTE, J.J.**

**RESERVED ON : 20/09/2016
PRONOUNCED ON: 27/09/2016**

JUDGMENT : (Per M.S. Sanklecha, J.)

1. None appears for the Revenue inspite of the service being completed in 1999. The affidavit of service dated 5th August, 2016 is filed.

2. By this Reference under Section 256(1) of the Income Tax Act, 1961 (the Act), the Income Tax Appellate Tribunal (the Tribunal) seeks our opinion on the following substantial question of law :-

“Whether on the facts and in the circumstances of the case, it could be said that there was a transfer of capital assets by the applicant company resulting in capital gains of Rs.1,19,26,177/- which could be subjected to capital gains tax in the hands of the applicant for the Assessment Year 1980-81 ?”

3. The assessment year relevant to the present proceedings is A.Y. 1980-81, for which the accounting year ended on 21st October, 1979.

4. Briefly, the facts leading to the above substantial question of law are as under :-

(a) The applicant company was incorporated in the year 1937 to carry on investment business.

(b) On 23rd April, 1979, the applicant Company at its General Body meeting of shareholders decided to commence a new business activity *inter alia* of dealing / trading in immovable properties, shares and securities. Besides, the General Body of shareholders authorized its Board of Directors to do the said business as they think fit and proper either itself or in partnership with others.

(c) On 2nd May, 1979, the applicant assessee converted certain plots of land and shares hitherto held as investments into its stock in trade.

On 8th May, 1979, the applicant assessee entered into the partnership firm with six others to trade in land, stock and shares by executing a partnership deed. The firm was styled M/s. Bajaj Trading Company. The applicant Company contributed total Capital of Rs.1.23 crores consisting of Rs.1.20 crores in the form of plot of land (immovable property), Rs.1.13 lakhs in the form of shares in limited companies and Rs.2 lakhs in the form of cash. Other parties also contributed in the same manner, resulting in initial Capital brought in by the partners to an aggregate of Rs.2.49 crores.

(d) On the aforesaid facts, the applicant assessee filed its Return of income for the subject assessment year declaring an income of Rs. 5.95 lakhs. However, the Assessing Officer while passing an Assessment Order dated 13th February, 1984 determined the income at Rs.1.25 crores under Section 143(3) of the Act. This was on account of the fact that he held that the transfer of immovable property and shares and securities into the partnership firm M/s. Bajaj Trading Company resulted in long term capital gains of Rs.1.19 crores.

(e) Being aggrieved by the assessment order dated 13th February, 1984, the applicant assessee filed an appeal to the Commissioner of Income Tax (Appeals) [CIT(A)]. The CIT(A) by order dated 11th November, 1985 *inter alia* held that :-

- (i) The conversion of investment in the form of immovable property and shares into stock in trade was not a sham or bogus act;
- (ii) The setting up of the partnership firm M/s. Bajaj Trading company was not a sham but a genuine firm which is granted registration and is also assessed under the Act;
- (iii) However, notwithstanding the conversion of investment into stock in trade, at the time of contribution into the partnership firm M/s. Bajaj Trading Company, it reverted to its earlier character of capital assets;
- (iv) There was transfer of assets to the firm within the meaning of Section 2(47) r/w Section 45 of the Act in view of the decision of the Supreme Court in ***Sunil Siddharthbhai Vs. Commissioner of Income Tax, reported in 156 ITR 509.*** However, he proceeded to hold that as no consideration was received within the meaning of Section 48 of the Act, no capital gains arose;
- (v) However, the applicant company had so arranged its affairs that when it is taken as a whole, it was device / scheme to evade capital gains tax and would squarely fall within the caution set out in paragraph 20 of *Sunil Siddharthbhai* (supra).

In the aforesaid circumstances, the CIT(A) concluded that there

was a transfer within the meaning of Section 2(47) r/w Section 45 of the Act and upheld the order dated 13th February, 1984 of the Assessing Officer, while restoring the issue to the Assessing Officer to determine the value of the capital asset as on 1st January, 1964 to compute its costs.

(f) Being aggrieved, the applicant assessee filed a further appeal to the Tribunal. By its order dated 16th July, 1988, the Tribunal rendered the following findings :-

(i) That the conversion of capital asset into stock in trade by the applicant company before investing the same in the partnership firm M/s. Bajaj Trading Company, was in fact, a part of a device so as to evade payment of tax. Consequently, it held that what was contributed to the partnership firm was a capital asset and not stock in trade;

(ii) The contribution of the capital asset to the firm M/s. Bajaj Trading Company was a transfer within the meaning of Section 2(47) r/w Section 45 of the Act as held by the Apex Court in *Sunil Siddharthbhai* (supra);

(iii) The applicant company had after three years withdrawn an amount of Rs.1.16 crores from the firm M/s. Bajaj Trading Company. This amount of Rs.1.16 crores was out of advances

received by the firm M/s. Bajaj Trading Company as advances on the sale of plots;

On the aforesaid facts, the Tribunal came to the conclusion that the effect of all the transactions taken together was that the applicant assessee was able to transfer its land to another entity i.e. partnership firm and received the market value of the same without having paid any tax. Thus, on application of paragraph 20 of the Supreme Court decision in *Sunil Siddharthbhai* (supra), the contribution of the capital asset into the firm was a device or ruse to convert a capital asset into money while evading capital gain tax. Thus, the appeal of the applicant company was dismissed.

5. Consequent to the above, the Tribunal has framed the substantial question of law hereinabove for our consideration. The aforesaid question subsumes within itself four issues, which arise for our consideration, as under :-

- (a) Was the capital contribution in the form of immovable property, stocks and shares a capital asset or stock in trade?
- (b) Was the capital contribution made by way of transfer of the capital assets to the partnership firm M/s. Bajaj Trading Company a

transfer of capital asset in terms of Section 2(47) and 45 of the Act?

(c) Did the transfer of capital asset result in capital gains of Rs.1.19 crores to be subjected to capital gains tax in the hands of the applicant assessee ? and

(d) If yes, then whether the capital gain is taxable in the A.Y. 1980-81 ?

6. So far as the character of immovable property, shares and securities invested by the applicant company into the partnership firm M/s. Bajaj Trading Company as a stock in trade as contended by the applicant or capital asset as held by the Tribunal is concerned, the same need not be examined. This for the reason that applicant company has contended that even if it is assumed that what was transferred was a capital asset, yet the transaction is not exigible to capital gain tax. However, it does reserve its right to contend otherwise, in case the Court does not accept its contention that no capital gain tax is payable on its contribution of capital asset i.e. immovable property, share and securities invested in M/s. Bajaj Trading Company. Therefore, for the present, we proceed on the basis that what has been invested in the partnership firm by the applicant assessee was a capital asset in the hands of the applicant assessee.

7. So far as the second issue which arises in the question as formulated, namely, whether the contribution of capital asset into the firm is a transfer of a capital asset within the meaning of section 2(47) r/w Section 45 of the Act is concerned, the same is no longer *res integra* in view of the decision of the Apex Court in *Suila Siddharthbhai* (supra). This is also not disputed by the applicant company before us. In the result, we hold that there is a transfer of a capital asset when the applicant company introduced its immovable property, shares and securities as its contribution to the capital of the partnership firm M/s. Bajaj Trading Company.

8. The third issue which arises for our consideration is whether any capital gain arises on account of transfer of the capital asset by the applicant assessee by way of its capital contribution to the partnership firm M/s. Bajaj Trading Company. We find substance in the submission of Mr. Mistri, learned Senior Counsel for the applicant assessee, that no capital gain chargeable to tax arises on the amount contributed as capital into the partnership firm. This on the basis that at the relevant time, it did not give rise to receipt of any determinable consideration to the transferor as contemplated in Section 48 of the Act.

9. We find that the Apex Court in *Sunil Siddharthbhai* (supra) has relied upon its earlier decision in ***Commissioner of Income Tax Vs. B.C. Srinivasa Setty, 128 ITR 294*** to hold that where the computation provision fails then, the charging Section cannot be invoked. The consideration received for the transfer of assets into a partnership firm is only a right of the partner during the subsistence of the partnership firm to get his share of profits from the partnership firm and after dissolution of the partnership or on his retirement from the partnership, to get the value of his share in the net assets on the date of the dissolution or retirement. The Apex Court had held that the credit entry in the partners' capital account does not represent the true value of the consideration received / receivable. It is only a notional value. Therefore, it is not possible to predicate the share of a partner in the partnership firm as on the date of dissolution or retirement, as a share which is presently payable or ascertainable. This is particularly so, as we are concerned with a period prior to A.Y. 1988-89 when sub-section(3) to Section 45 of the Act was introduced. Section 45(3) of the Act provides that the amounts credited / recorded in the books of accounts of the firm would be deemed to be the full consideration received by the partner as a result of any transfer, chargeable to capital

gain tax. Therefore, for the period for which we are concerned, i.e. A.Y. 1980-01, it cannot be said that any particular consideration is received by a partner on making contribution of a capital asset into a partnership firm. Consequently, the capital gains earned by the applicant assessee cannot be determined in terms of Section 48 of the Act. Therefore, as held by the Apex Court in *B.C. Srinivasa Setty* (surpa), where the computation provision is not workable, the charge itself fails.

10. Further reliance is placed by the applicant assessee upon the Apex Court decision in *Sunil Siddharthbhai* (supra) to contend that on the date of the contribution of capital to the partnership firm, it cannot be said that in a true commercial sense as understood by a businessman, any real income or gain arises in the hands of the applicant assessee. It is pertinent to note that we are concerned with the period prior to the introduction of Section 45(3) of the Act, which was introduced w.e.f. Assessment Year 1988-89. Sub-section 3 was specifically introduced to overcome the decision of the Apex Court in *Sunil Siddharthbhai* (supra) to provide that the amount recorded in the books of the firm as the value of the capital asset shall be deemed to be the full value of the consideration, as a result of the transfer, and that

capital gains so arrived at shall be chargeable to tax in the year in which the transfer takes place. As we are dealing with the period prior to the introduction of Section 45(3) of the Act, the same will not govern the present proceedings. Thus, the obiter (not the basis of the order) by the Tribunal that sub-section (3) of Section 45 only clarifies the existing position in law runs counter to Circular No.495 dated 22nd September, 1987 issued by the Central Board of Direct Taxes at the time of amendments made by Finance Act, 1987. The above Circular states that Sub-Section (3) of Section 48 of the Act was brought into the Act in view of the decision of the Apex Court in *Sunil Siddharthbhai* (supra) that conversion of any personal asset into an asset of a firm in which the individual is a partner would not give rise to capital gains tax for failure of consideration. It specifically provides that the amendment will come into force w.e.f. 1st April, 1988 and will accordingly apply for A.Y. 1988-89 and subsequent assessment years. In fact, the Apex Court in *Commissioner of Income Tax Vs. Vatika Township (P) Ltd. 2015 (1) SCC 1* has held that Circulars issued by the CBDT at the time of amendment of the Act by the Finance Act, explaining the provisions, are binding upon the Revenue.

11. The Authorities under the Act have all along proceeded on the

basis that the amounts contributed as capital in the partnership firm by the applicant assessee resulted in capital gains of Rs.1.19 crores. This entirely on the basis of the caution expressed by the Apex Court in *Sunil Siddharthbhai* (supra) at page 523 thereof in the following terms :-

“We have decided these appeals on the assumption that the partnership firm in question is a genuine firm and not the result of a sham or unreal transaction and that the transfer by the partner of his personal asset to partnership firm represents a genuine intention to contribute to the share capital of the firm for the purpose of carrying on the partnership business. If the transfer of the personal asset by the assessee to a partnership in which he is or becomes a partner is merely a device or ruse for converting the asset into money which would substantially remain available for his benefit without liability to income-tax on a capital gain, it will be open to the income-tax authorities to go behind the transaction and examine whether the transaction of creating the partnership is a genuine or a sham transaction and, even where the partnership is genuine, the transaction of transferring the personal asset to the partnership firm represents a real attempt to contribute to the share capital of the partnership firm for the purpose of carrying on the partnership business or is nothing but a device or ruse to convert the personal asset into money substantially for the benefit of the assessee while evading tax on a capital gain. The Income Tax Officer will be entitled to consider all the relevant indicia in this regard, whether the

partnership is formed between the assessee and his wife and children or substantially limited to them, whether the personal asset is sold by the partnership firm soon after it is transferred by the assessee to it, whether the partnership firm has no substantial or real business or the record shows that there was no real need for the partnership firm for such capital contribution from the assessee. All these and other pertinent considerations may be taken into regard when the Income-tax Officer enters upon a scrutiny of the transaction, for, in the task of determining whether a transaction is a sham or illusory transaction or a device or ruse, he is entitled to penetrate the veil covering it and ascertain the truth.”

(emphasis supplied)

12. In the present facts, both the CIT(A) as well as the Tribunal have concurrently recorded a finding of fact that the partnership firm M/s. Bajaj Trading Company is a genuine firm. However, the Authorities have proceeded on the basis of the above observation in *Sunil Siddharthbhai* (supra) that even where the partnership is genuine and the transfer of any asset to a partnership firm is contribution to the share capital of the firm by the partner, yet on examination of all the facts, the Assessing Officer may come to a finding that the contribution to the firm is nothing but a device to convert an asset into money for the benefit of the assessee while evading tax on the capital gains.

However, from the aforesaid paragraph of the Apex Court in *Sunil Siddharthbhai* (supra) quoted above, the tests are whether the asset contributed to the firm is sold soon after its transfer or whether the partnership has no real or substantial business which would require capital contribution from the assessee. In the present facts, it is an undisputed position that the partnership firm was a registered partnership firm under the Act and is assessed to tax as such. The partnership firm has continued its business of trading in land, shares and securities for all these years and even continues to exist today and is being assessed to tax. This itself indicates that the contribution by the applicant assessee into the partnership firm as capital was required by the firm to carry on its business is not a device to evade tax which would have otherwise been payable. In fact, the Authorities under the Act also record the fact that at the commencement of its business the firm had in the aggregate a capital contribution of all its partners aggregating to Rs.2.49 crores out of which the applicant assessee had contributed an amount of Rs.1.23 crores i.e. Rs.1.20 crores in the form of immovable property i.e. land and Rs.1.13 lakhs in the form of shares in the limited company and Rs. 2 lakhs in cash.

13. It may also be noted that 3 years next after having introduced its

capital into the partnership firm, the applicant Company withdrew its capital to the extent of Rs.1.16 crores. On the basis of this fact, the Authorities conclude that the applicant assessee had received the value of the capital contribution made by it into the partnership firm by receiving the value of the immovable property from the firm. Thus, the entire exercise was a mere device to evade capital gains tax. However, the Revenue is completely ignoring the finding of fact recorded by the Tribunal to the effect that the amount of Rs.1.16 crores and other amounts withdrawn by the other partners were on receipt of advances by the firm against sale of its plots. Thus, the amounts were received by the partnership firm in the process of carrying on its business of developing land and, therefore, return of capital from out of these receipts cannot be said to be a device / strategy to evade tax, which would otherwise be payable by the applicant assessee. It must be borne in mind that the applicant assessee had decided to carry on business in the partnership firm with others by contributing an amount of Rs.1.23 crores as its capital while other partners also contributed varying amounts resulting in an aggregate balance in the partnership capital account of Rs.2.49 crores. Thus, it was a decision taken by the applicant assessee to pool its resources along with other persons who have contributed over 50% of the total capital in the partnership firm.

This itself is a further indication of the fact that a decision was taken by the applicant assessee to enter into a partnership firm and form the firm M/s. Bajaj Trading company only with a view to engage in a new line of business i.e. trading in land, shares and securities so as to generate profits along with other persons who had equally contributed to the capital of the firm. Thus, in these facts, the contribution of capital asset into the partnership firm M/s. Bajaj Trading Company, cannot be said to fall within the mischief as indicated by the Apex Court in *Sunil Siddharthbhai* (supra) as extracted hereinabove.

14. In any case, at the time when the applicant assessee made its contribution of capital assets into the partnership firm, no consideration was received by the applicant assessee. If at all, the firm is held to be not genuine, then, the consideration received for transfer of the property was only 3 years down the line. Consequently, it would not be fair to bring it to tax in the A.Y. 1980-81. In the result, we hold that there is a transfer of capital asset by the applicant assessee to a partnership firm M/s. Bajaj Trading company and yet, the same would not result in capital gains which can be subjected to capital gains tax in the A.Y. 1980-81.

15. We may point out that whether the transferred asset was a capital asset or stock-in-trade makes no difference. This for the reason that the subsequent steps taken by the Company of introducing these assets into partnership firm and the manner in which it has been dealt with thereafter by the firm does not indicate that the conversion was a device/ruse to evade capital tax gains. Therefore, the transaction as a whole does not fall within the caution provided in Sunil Siddharthbhai (supra).

16. In the above view, we have proceeded on the basis that the immovable property, stock and security were capital assets in the hands of the Applicant-Company when introduced into the partnership firm – M/s. Bajaj Trading Company. Moreover, the Authorities have held that the partnership firm was genuine and not a colourable device. Therefore, the investment made in it, cannot be a device when seen in the light of the subsequent conduct of the partnership firm of dealing in immovable properties, stocks and securities as its stock-in-trade for the subsequent years. In fact, we are informed the firm continues to do so till date and is being assessed to tax as a dealer in immovable property, stocks and securities. In the circumstances, when the transaction is looked at in its entirety, the investment made cannot be said to be ruse

to evade tax (see Vodafone International v/s. Union of India 341 – ITR-1).

17. Accordingly, we answer the question partly in the affirmative to the extent the Tribunal held that there was a transfer of capital asset when the applicant assessee made its capital contribution in the form of land, shares and securities to the partnership firm M/s. Bajaj Trading Company. However, other parts of the question namely that the transfer of capital assets resulted in capital gains, which can be subjected to capital gain tax in the subject assessment year, is answered in the negative, i.e. in favour the of the applicant assessee and against the Revenue.

18. The Reference is disposed of in the above terms. No order as to costs.

(S.C. GUPTE, J.)

(M.S. SANKLECHA, J.)