

SUREME COURT OF INDIA

Commissioner of Income-Tax, Kerala

Vs.

R.R. Ramakrishna Pillai

(J Shah, S Sikri and V Ramaswami JJ.)

05.05.1967

JUDGMENT

SHAH, J.

1. An association of five persons carried on a business in the name and style of "Morning Star Bus Service" - hereinafter called "the service". On may 31, 1955, the business was transferred to the morning Star Bus Service (Private) Ltd. - hereinafter called "the Company". The assets transferred by the service to the company consisted of seven motor buses and a workshop and the consideration for the transfer as entered in the profit and loss account of the service was Rs. 74,000. The written down value of the seven motor buses in the books of account of the service was Rs. 24,302. In a proceeding for assessment to tax in the year 1956-57 the Income-tax Officer held that out of the consideration of Rs. 74,000, Rs. 4,000 should be allocated to the workshop assets (in respect of which no depreciation has been previously allowed), and the balance of Rs. 70,000 be taken into account under section 10(2) (vii), proviso two of the Indian Income- tax Act, 1922, as profit of the service. The Appellate Assistant Commissioner agreed with the view of the income-tax Officer. He observed that "the sale value of the assets would be taken at Rs. 70,000 for the 7 buses" and the excess over the written down value of the seven buses was liable to be brought to tax under section 10(2) (vii) proviso two. The Income-tax Appellate Tribunal, following the judgments of the Bombay High Court in Rogers & Co. v. Commissioner of Income-tax and in Commissioner of Income-tax v. Sir Homi Mehtas Executors, reversed the order of the Appellate Assistant Commissioner. The Tribunal held that the arrangement by which the private limited company took over the business of the society was merely intended to readjust the position of the society qua the ownership of the motor buses, and no sale was intended and on that account the difference between Rs. 70,000 and the written down value of the motor buses could not be brought to tax under section 10(2) (vii) of the Indian Income-tax Act.

2. At the instance of the Commissioner, the Tribunal referred the following question to the High Court of Kerala :

"Whether the sum of Rs. 45,698 is assessable to tax under the provisions of the second proviso to section 10(2) (vii) of the Income- tax Act ?"

3. The High Court answered the question in the negative. The High Court observed :

"What the second proviso (to section 10(2) (vii)) brings charge is the profit that a vendor makes

from a vendee as the result of a sale. If no sale or profit in any commercial sense occurs because of the virtual identity of the vendor and the vendee, as the case before us, it cannot be said that the second proviso is attracted and that a tax liability does arise."

4. The Commissioner of Income-tax has appealed to this court, with special leave.

5. Counsel for the Commissioner contended that a company is in law a legal entity distinct from the shareholders who have interest in its business and the transaction under which a company formed by the persons interested in the business to take over that business, is of the nature of sale when in lieu of the value of their interest shares of the company are allotted. Counsel said that in determining the true nature of a transaction, for the purpose of assessing tax liability, the Tribunal cannot ignore the strict legal position and rely upon what it believes is the substance of the transaction. Counsel relies in support of that contention upon the judgment of the Judicial Committee in *Bank of Chettinad Ltd. v. Commissioner of Income-tax and Inland Revenue Commissioners v. Duke of Westminster* and submitted that the decision relied upon by the Tribunal and the High Court (*viz.*, *Sir Homi Mehta's Executor's case* and *Rogers & Co.'s case*) do not lay down the correct principle. He invited us to accept the principle of the judgment of the Patna High Court in *Maharajadhiraj Sir Kameshwar Singh v. Commissioner of Income-tax*.

6. We are of the view that the conflict need not be resolved in this case. The Tribunal has not clearly found the facts relating to the true nature of the transaction under which the business of the society was taken over by the company, and the question referred by the Tribunal cannot be answered unless the facts are determined.

7. In paragraph 2 of the statement of the case the Tribunal stated that seven motor buses belonging to the assessee association were taken over by the company for Rs. 70,000. The Income-tax Officer, it appears, had found that the company had purchased the assets for a consideration of Rs. 70,000 from the society. The Appellate Assistant Commissioner observed in paragraph 3 of his judgment that the value of the motor buses transferred was Rs. 70,000. In his view whatever may be the reasons for transfer of the business, the purchase price entered by the company had to be taken into account in applying the second proviso to section 10(2) (vii). The Tribunal did not attempt to ascertain the true nature of the transaction, but assumed that there was no sale of the society to the company, because "in identical circumstances" the High Court of Bombay had held that there was no sale.

8. A transaction by which a person carrying on business transfers the assets of that business to another assessable entity may take different forms and may have different legal effect. The assets of a business may be sold at a fixed price to a company promoted by a person who carried on the business : if the price paid for or attributable to an asset exceeds the written down value of the asset, proviso 2 to section 10(2) (vii) would *ex facie* be a company in consideration of allotment of shares, it would be a case of exchange and not of sale, and the true nature of the transaction will not be altered, because for the purpose of stamp duty or other reasons the value of assets transferred is shown as equivalent to the face value of the shares allotted. A person carrying on business may agree with a company floated by him that the assets belonging to him shall be transferred to the company for a certain money consideration and that in satisfaction of the liability to pay that money consideration, shares of a certain face value shall be allotted to the transferor. In that case there are in truth two transactions - one a transaction of sale and the other a contract under which shares are accepted in satisfaction of the liability to pay the price.

9. Section 10(2) (vii), proviso 2, on the plain terms used therein, is attracted if there be sale of the building, machinery or plant and the amount for which the sale takes place exceeds the written down value of the assets transferred. If there be no sale, the proviso has no application. For the application of the proviso, it is necessary to precisely determine the facts and to as certain in which of the different categories a transaction falls. The Tribunal cannot admit a transaction which has distinct characteristics to exemption from tax liability on the broad ground that the substance of the transaction was to readjust the position of the transferor as holder of the assets transferred.

10. The facts on the basis of which the question may be answered have not been clearly found by the Tribunal. It is true that in the profit and loss account of the service, the motor buses transferred to the company were valued Rs. 70,000 and same value as entered in the books of account of the company. It appears from the statement made by the Appellate Assistant Commissioner that the shares of the face value of Rs. 70,000 were allotted to the five persons who were carrying on the business in the name of the service. This transaction may be one in which there was a sale of the motor buses for Rs. 70,000 and in satisfaction of the liability to pay that amount the company allotted shares of the face value of Rs. 70,000 to the members of the association. In that case the transaction may be deemed to be one of sale, and the application of section 10(2) (vii), proviso 2, would be invited. If, however, the transaction was one in which in consideration of the transfer of seven buses, the company allotted shares of the face value of Rs. 70,000 to the members of the association. In that case the transaction may be deemed to be one of sale, and the application of section 10(2) (vii), proviso 2, would be invited. If, however, the transaction was one in which in consideration of the transfer of seven buses, the company allotted shares of the face value of Rs. 70,000, the transaction would be one of exchange.

11. Unless, therefore, the relevant facts which have a bearing on the question are clearly found by the Tribunal, we are unable to record any answer on the question referred to the High Court.

12. We, therefore, discharge the answer recorded by the High Court and declare that no answer can be recorded on the question referred by the Tribunal in the absence of any clear finding recorded by the Tribunal. It will be open to the Tribunal to rehear the parties under section 66(5) of the Indian Income-tax Act and to record clear findings in the light of the observations made in this judgment. There will be no order as to costs in this appeal.