Commissioner of Gift-Tax, Kerala

Vs

P. Gheevarghese, Travancore Timbers and Products

Civil Appeal No. 2293 of 1968

(K.S. Hegde, A.N. Grover JJ)

20.09.1971

JUDGMENT

GROVER J. -

1. This is an appeal by special leave from a judgment of the Kerala High Court in a reference made under section 26(1) of the Gift- tax Act, 1958, hereinafter referred to as the "Act" relating to the assessment year 1964-65. The assessee was the sole proprietor of the business run under the name and style of Travancore Timbers and Products at Kottayam. He converted the proprietary business into a partnership business by means of a deed of partnership dated August 1, 1963. The partnership consisted of the assessee and his two daughters. The capital of the partnership was to be Rs. 4,00,000. The assessee contributed Rs. 3,50,000 and each of his two daughters, one of whom was married and the other unmarried, contributed Rs. 25,000. The contribution of the capital by the daughters was effected by transfer of Rs. 25,000 from the assessee's account to the account of each of the daughters. All the assets of the proprietary business were transferred to the partnership. In these assets the assessee and his daughters were entitled to shares in proportion to their share capital. In other words, the assessee was entitled to a 7/8 share and each of his daughters to 1/16 share. The profits and losses of the partnership business, however, were to be divided in equal shares between all the three partners. The assessee was the managing partner of the firm. The assessee filed a return of gift tax for the assessment year 1964-65 in respect of the gift of Rs. 50,000 in favour of hid daughters representing the share capital contributed by his daughters. The Gift tax Officer, however, took the view that in addition to the gift of the aforesaid amount the assessee had gifted 1/3rd portion of the goodwill of his proprietary business to each of his daughters. On the basis of the profits of the earlier years the Gift-tax Officer determined the value of the goodwill at Rs. 1,61,865 and the value of the 2/3rd share of the goodwill gifted to the daughters at Rs. 1,07,910 which was added to the amount of Rs. 50,000 and the gift-tax was assessed accordingly. The assessee preferred and appeal to the Appellate Assistant Commissioner of gift-tax which was dismissed. The Appellate Tribunal on appeal held : (i) the goodwill constituted an existing immovable property at the time of the admission of the assessee's daughters into the business; (ii) the gift was exempt under section 5(1) (xiv) of the Act as the assessee was actually carrying on the business when he admitted his two daughters into it, the main intention of the assessee being to ensure continuity of the business and two prevent its extinction on his death. Such a purpose amounted to business expediency and, therefore, all the conditions of section 5(1) (xiv) were satisfied; (iii) the goodwill was a capital asset and the assessee's daughters had only 1/8th share in the assets of the business. The gift or the goodwill were, therefore, only of 1/8th share. The following question of law were referred by the Tribunal at the instance of the Commissioner of gift- tax :

"(i) Whether, on the facts and in the circumstances of the case, their goodwill of the

assessee's business is an existing property within the meaning of section 2(xii) of the Gift-tax Act ?

(ii) Whether, on the facts and in the circumstances of the case, the assessee gifted only a 1/8th share in the good will of the business to his two daughters or whether he gifted a 2/3rd share ?

(iii) Whether, on the facts and in the circumstances of the case, the gift was exempt from assessment under section 5(1) (xiv) of the Gift- tax Act ?"

The High Court answered all the questions in favour of the assessee and against the revenue.

It is essential to look at the deed of partnership closely because certain clauses which have a material bearing do not appear to have received the attention either of the Appellate Tribunal or the High Court. It was recited, inter alia, that the assessee was desirous of introducing into the business of Travancore Timbers and Products his major daughters and also his minor children as and when they attained majority. It was next stated that upon the treaty for the introduction of the said partners into the business and for the partnership it was agreed that the first partner (assessee) would gift a sum of Rs. 25,000 to each of his two major daughters. The property of the business was next described. It was stated to consist of the land and buildings, plant, fixtures and machinery, book debts, benefits of existing contracts, etc., and stock-in-trade and other movable chattels and effects. The assessee as beneficial owner conveyed and assigned unto the partners including himself all these properties including the goodwill of the marks and all rights and privileges belonging thereto. Each of the partners covenanted that he or she will duly pay, discharge or perform all the debts and liabilities, contract and engagements of the individual business of the assessee subsisting in the shares and proportions in which they respectively became entitled under the business. It was expressly stated in the first schedule which contained the terms, conditions and stipulations that the partnership was to be at will. Clause (2) in the schedule is of particular importance. According to clause 2(a) if the partners or partner who, for the first time, represented or possessed the major part in the value of the capital of the business desired to continue the business with additional partners they, he or she would be at liberty to do so on giving 6 moths' previous notice to the other partner or partners paying to the partners or partner not desiring to continue the value of their his or her shares or share and interest in the business, property and the goodwill and giving a bond of 'indemnity" with regard to the mode of ascertaining such value and the payment thereof and the amount of the penalty of such bond and otherwise as if the partnership had under these presents been stipulated to continue after the 31st day of March, 1964, and such other partners or partner had happened to die immediately after the last mentioned day. It was further provided that if the 31st day of March, 1964, passed without the then partners or partner who possessed the major part in the value of the capital having given the aforesaid notice then the partners or partner who, for the first time, represented or possessed a minor part in value not being less than two equal third parts of the capital would be at liberty to continue the business by giving six calendar months' previous notice of their, his or her desire to do so and paying to the partners, or partner not desiring to continue the value of their, his or her shares or share and interest for the time being of the business and the property and goodwill thereof, etc. If the partnership was to continue under either of the eventualities mentioned before every partner for the time being who desired to continue would have the right to do so. Clause 7 laid down that the parties shall be entitled to the capital and property of the partnership for the time being in the following shares; "The said first partner, Ghee Varghese, shall be entitled to 7/8th share thereof and each of second and their partners to 1/16th part thereof." Clause 8(a) and clause 9 are reproduced below :

> "8(a) the capital of the partnership shall be the sum of Rs. 4,00,000 (rupees four lakhs only) being the value ascertained as aforesaid of the property of the said late business taken over by the said parties hereto and of such further capital as shall be hereafter contributed by the partners and all such further capital shall whether the same shall be contributed out of the profits or otherwise be contributed by the partners for the time being in the shares in which they are for the time being entitled to the existing capital of the partnership."

9. The net profits or losses of the partnership shall subject to the provisions of these presents belong to the partners for the time being in equal shares."

Under clause 10 the assessee was to be the managing partner of the firm. He alone had the power to sign the cheques on account of the partnership in the name of the firm. He had the power to borrow from banks and other private parties for the purpose of the business and to execute bonds, documents, agreements and other activities as might be necessary. There were other provisions also which showed that it was the assessee who retained substantially the control of the running of the business in his own hands. Clause 17 provided that whenever any of the partners died during the continuance of the partnership then the partnership would not be dissolved between the surviving partners and fairly elaborate provisions were made with regard to what would pass to the representative of such deceased partner from out of the properties and assets of the partnership as also its profits. The partnership deed also contained what were called special provisions as to the share of the first partner. Clause 18 provided that the assessee who was the first partner could nominate either one or all of his minor children to be a partner or partners on their attaining majority. Such nomination or appointment could be made by a will or codicil.

It is somewhat surprising that the Gift-tax Officer picked up only one of the assets of the business of the assessee, namely, the goodwill, or treating that as a gift, apart from the amount of Rs. 50,000 which had admittedly been gifted to the daughters. It was mentioned in the assessment order that, as the assessee had failed to disclose the gift relating to the same, action under section 17(1) (c) was being taken. Before the Appellate assistant Commissioner it was contended, inter alia, that the value of the goodwill should not be included as a part of the gift. Alternatively, it was contended that the value had been calculated correctly. This was apart from the other contentions which were raised claiming exemption under section 5(1) (xiv) of the Act. Without examining the contentions that the value of the goodwill should not be included as a part of the gift the appellate Assistant commissioner examined the other contentions and agreed with the view taken by the Gift-tax Officer. The way the Tribunal examined the question relating to the goodwill was by treating it as an asset which had been gifted by the assessee to his two daughters. This is what the Tribunal observed :

> "By admitting his two daughters, as partners of the business, the assessee also admitted them to the benefits arising out of the goodwill of the business."

Now it is quite clear that according to the deed of partnership and even otherwise on admitted fact goodwill was a part of the properties and assets of the business which the assessee was running under the style of Travancore Timber and Products at Kottayam. All these were valued at Rs. 4,00,000. The entire property of the assessee's proprietary business was transferred to the new partnership. According to clause 7 in the schedule to the partnership deed the parties were to be entitled to the capital and property of the partnership in the following shares :

#Assessee ... 7/8th share.Each daughter ... 1/16th share.##

These shares were proportionate to the capital with which the partnership was stated to have been started. Out of Rs. 4,00,000 the assessee was deemed to have contributed Rs. 3,50,000 and each of the daughters Rs. 25,000. The goodwill, as stated earlier, was a part of the assets which had been transferred to the partnership. Under section 14 of the Indian Partnership Act, subject to contract between the partners, the property of the firm includes all property and rights and interests in property originally brought into the stock of the firm or acquired by purchase or otherwise by or for the firm and includes also goodwill of the business. The departmental authorities, in the present case, never treated all the assets and property of the assessee which where transferred to the partnership pertaining to his proprietary business as a gift nor has any suggestion been made before us on behalf of the revenue that the property and assets valued at Rs. 4,00,000 were the subject-matter of gift. All that the departmental authorities did and that position continued throughout was that they picked up one of the assets of the assessee's proprietary business, namely, its good will, and regarded that as the subject of gift having been made to the daughters who were the other partners of the firm which came into existence by virtue of the deed of partnership. This approach is wholly incomprehensible and no attempt has been made before us to justify it. In our opinion the second question which was referred by the Tribunal should have been framed as follows :

> "Whether, on the facts and in the circumstances, any gift-tax was payable on the goodwill of the assessee's business. If the answer be in the affirmative how much share in the goodwill was liable to such tax ?"

We reframe the question in the above terms. It is quite obvious that the answer to the first part of the question has to be in the negative and therefore there is no necessity of answering the second part of the question. Question No. 1 also does not arise and need not be answered.

We may next deal with the third question. Section 5 of the Act gives the exemptions in respect of certain gifts. Sub-clause (xiv) of sub- section (1) is as follows :

> "5. (1) Gift-tax shall not be charged under this Act in respect of gifts made by any person -.....
>
> (xiv) in the course of carrying on a business, profession or vocation, to the extent to which the gifts is proved to the satisfaction of the Gift-tax Officer to have been made bona fide for the purpose of such business, profession or vocation."

The critical words are "in the course of" and "for the purpose". Therefore, the gift should be proved to have been made not only "in the course of carrying on the business, profession or vocation" but also bona fide for the purpose of such business, profession or vocation. The words "in the course of" were considered by this court in State of Travancore Cochin v. Shanmugha Vilas Cashew Nut Factory, in connection with the language employed in article 286 of the Constitution. It was pointed out that the word "course" etymological denotes movement from one point to another and the expression "in the course of" not only implies a period of time during which the movement is in progress but also postulates a connected relation. There clause 1(b) of the article was under consideration and what was exempted under the clause was the sale or purchase of the goods taking place in the course of the import of the goods into or export of the goods out of the territory of India. The only assistance which can be derived in the present case is the emphasise on there being connected relation between the activities for which these words are used. Thus the expression "in

the course of carrying on of business, etc." means that the gift should have some relationship with the carrying on of the business. If a donor makes a gift only while he is running the business that may not he sufficient to bring the gift within the first part of clause (xiv) of section 5(1) of the Act. It must further be established, to bring the gift within that provision, that there was some integral connection or relation between the making of the gift and the carrying on of the business.

Under clause (xiv) of section 5(1) the second requirement is that the gift should have been made bona fide for the purpose of such business, etc. According to the meaning of the word "purpose" in Webster's New International dictionary, it is that which one sets before himself as an object to be attained; the end or aim to be kept in view in any plan, measure, exertion or operation; design, intention. Therefore, on the plain meaning of the word "purpose", as employed in clause (xiv), the object, plan or design must have connection or relationship with the business. To put it differently the object in making the gift or the design or intention behind if should be related to the business. Some assistance may be derived from the language used in section 10(2) (xv) of the Income-tax Act, 1922. According to that provision any expenditure laid out or expended wholly and exclusively for the purpose of business, profession or vocation is a permissible deduction in the computation of profits. In B. W. Noble Ltd. v. Mitchell a sum had been paid to a retiring director in very peculiar circumstances. The object of making the payment was that of preserving the status and reputation of the company which the directors felt would be imperilled either by the other director remaining in the business or by a dismissal of him against his will involving proceedings by way of action in which the good name of the company might suffer. Sargant L. J. was of the view that preservation of the status and dividend earning power of the company was well within the ordinary purpose of the trade, profession or vocation of the company. Indeed, the English court have refrained from adopting any dogmatic or set line for discovering the meaning of the expression "for the purpose of" when used in connection with trade or business because it is essentially a matter which depends on the various sets of circumstances and facts of a particular case for determining whether certain expenditure has been incurred for the purpose of the trade or business : (See Morgan v. Tate & Lyle Ltd.). According to a recent decision of this court in Civil Appeals Nos. 1351-1353, 1897 and 1241 of 1968 (Commissioner of Income-tax v. Birla Cotton spinning & Weaving Mills Ltd.), the expression "for the purpose of the business" is essentially wider than the expression "for the purpose of earning profits". It covers not only the running of the business or its administration but also measures for the preservation of the business, protection of its assets and property. It may legitimately comprehend many other acts incidental to the carrying on the business. Another test that has often been taken into consideration is whether the expenditure was necessitated or justified by commercial expediency.

The High Court, in the present case, relied on Commissioner of Gift- tax v. Dr. George Kuruvilla. There the assessee was doctor by profession at the time of the gift which he made in favour of his son who also joined his father's profession. The Kerala High Court took the view that the gift had been made in the course of carrying on of the business, profession or vocation within the meaning of section 5(1) (xiv) of the Act and also for the purpose of such business, profession or vocation. That decision was reversed by this court in Commissioner of Gift-tax v. Dr. George Kuruvilla. It has been observed that section 5(1) (xiv) of the Act does not indicate that a gift made by a person carrying on any business is exempt from tax nor does it provide that a gift is exempt from tax merely because the property is used for the purpose for which it was used by the donor. Without deciding whether the test of "commercial expediency" was strictly appropriate to the claim for exemption under the aforesaid provision this court held that there was no evidence to prove that the gift to the donee in that case was "in the course of carrying on the business" of the donor and "for the purpose of the business".

We are satisfied that in the present case also it has not been established that the requirements of section 5(1) (xiv) of the Act were satisfied. The assessee was certainly carrying on his business at the point of time when he admitted his two daughters into the firm. But from that fact alone it did not follow that the gift had been made in the course of the assessee's business nor could it be held that the gift was made for the purpose of carrying on the assessee's business. The Tribunal came to the conclusion that the partnership did provide for the continuance of the partnership business in spite of the death of the partner and that the main intention of the assessee was to ensure the continuity of the business and to prevent its extinction on his death. A true and correct reading of the deed of partnership indicates that the partners could go out from the partnership in terms of clause 2 of the schedule in the deed of partnership. Moreover, the partnership was expressly stated to be at will. The real intention of the assessee apparently was to take his daughters into the firm with the object of conferring benefit on them for the natural reason that the father wanted to look to the advancement of his daughters into the firm with the object of conferring benefit on them for the natural reason that the father wanted to look to the advancement of his daughters. It was further wanted to look to the advancement of his daughters. It was further provided in the deed that even the minor children would, in due course, be admitted to partnership. Clause 18 of the schedule already referred to laid down that the assessee could nominate either one or all of his minor children to be partner or partners on their attaining majority and such nomination or appointment could be made even by a will or codicil. The assessee retained complete control over the running of the partnership business and it can hardly be said that he needed any help for his daughters particularly when there is no evidence that he was in a weak state of health, his age being below 50 years. Moreover, there is nothing to show that the daughters had any specialised knowledge or business experience so as to be able to assist in the development or management of the business. We are wholly unable in these circumstances to our judgment there was no cogent material to come to the conclusion that the gift of Rs. 25,000 to each of the daughters by the assessee was "in the course of carrying on the business" of the assessee and was "for the purpose of the business".

It may be recalled that the assessee had himself made a return in the matter of assessment of gift-tax payable under the Act in respect of the amount of Rs. 50,000 which had been gifted by him to his two daughters. The answer to question No. 3, consequently, would be in favour of the revenue and against the assessee so far as that amount is concerned.

For the reasons given above the answers returned by the High Court are discharged and in their place the question shall stand answered in accordance with this judgment in the following manner :

#Question No. 1 : Does not arise.Question No. 2 :as reframed : The first part is answered in the negative and in favour of the assessee. The second part does not arise.Question No. 3 : The answer is in favour of the revenue and against the assessee so far as the gift of Rs. 50,000 is concerned.##

The appeal shall stand disposed of accordingly. In the circumstances of the case, we make no order as to costs.

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