SUPREME COURT OF INDIA

M/s. Sree Narayana Chandrika Trust

Versus

Commissioner of Gift Tax, Kerala

25.4.2003

(Brijesh Kumar and B.N. Srikrishna, JJ.)

Civil Appeal No. 1427 of 2001.

JUDGMENT

B.N. Srikrishna, J. - The appellant is a charitable institution registered as a public trust which spends its receipts on charitable purposes and is partner in a firm known as `Chandrika Enterprises'. By a partnership deed dated 1.4.1980 the appellant was inducted into the said partnership upon contribution of Rs. 1,000 to the total capital of Rs. 1,61,000 and given a share of 45% in the profit of the said firm. There were in all 8 partners apart from the appellant and the partnership deed recited the contribution of each partner towards the capital of the firm as also the varying share of profit/loss of each partner. With effect from 1.10.1982 the partnership was reconstituted by a deed dated 1.10.1982. A new partner, Smt. M.U. Indra was inducted into the partnership. Consequent upon the induction of said new partner, who contributed a sum of Rs. 25,000 towards the capital, the shares of the profit/loss of all the partners were reshuffled, being increased in the case of some and reduced in the case of the others. The share of profit/loss of each partner prior to 11.10.1982 and thereafter is as under :

		Prior to 11.10.82	From 11.10.82	Difference
1.	C.N. Purushothaman	10%	4%	-6%
2.	Mrs. P. Karthiayani Amma	5%	15%	+10%
3.	C.K. Jinan	10%	25%	+15%
4.	C.K. Santha	10%	10%	
5.	C.R. Kesavan Vaidyar (for and on behalf of	45%	30%	-15%
6.	M.G. Narayanan	5%	1%	-4%
7.	P.I. Janardhanan	5%	1%	-4%
8.	P.R. Rajappan	5%	1%	-4%
9.	M.K. Kumaran	5%	1%	-4%
10.	M.U. Indra		12%	+12%

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2. Clauses 9, 10 and 11 of the said partnership deed provide that all the partners had a right to carry on the business of the firm for the common advantage of the firm, though C.K. Jinan (Partner No. 3) was to be the managing partner and in overall charge of the affairs of the firm and C.N. Purushuthaman (Partner no. 1) was to be the administrative partner and incharge of the day to day affairs of the firm and allowed a salary of Rs. 1000 per month until otherwise decided by other partners. The bank accounts of the firm were to be operated by the Managing partner C.K. Jinan or administrative partner C.N. Purushuthaman. As a result of the reconstitution of the firm w.e.f. 1.10.1982, the appellant's share in the profit/loss of the firm was reduced from 45% to 30%.

3. The Gift Tax Officer, taking the view that the reduction of the share of the profit/loss of the appellant from 45% to 30% and re-distribution in favour of the other partners amounted to a gift, issued a notice under Section 16 of the Gift Tax Act calling upon the appellant assessee to file a return of a gift. The assessee filed a return showing the value of taxable gift at nil for the assessment year 1983-84. By an assessment order dated 31.12.1985 the Assessing Officer held that relinquishment of 15% of the share of the profits of the firm by the appellant-assessee amounted to a gift and, therefore, attracted the provisions of the Gift Tax Act. He took the average profits of the firm for the year 1982-83 to 1978-79 at Rs. 7,36,650 and, after reducing therefrom interest on capital @ 12% and managerial remuneration, arrived at 3 years purchase price at Rs. 21,16,000. He worked out that 15% of this amount i.e. Rs. 3,17,400 had been surrendered without consideration by the assessee. Consequently, after giving exemption under Section 5(2) he held that amount of Rs. 23,12,400 was liable to tax and directed payment of tax thereupon at Rs. 59,600.

4. The appellant-assessee challenged the assessment order by appeal before the Commissioner of Gift Tax (Appeals). Two contentions were urged by the appellant assesee. First, that there was no goodwill of the firm which was capable of being assessed in terms of money, and second, that inasmuch as M.U. Indira had made a capital contribution and was inducted as partner, there was no situation of a gift at all. The appeal was dismissed.

5. The assessee carried the matter in appeal to the Income Tax Appellate Tribunal. Before the tribunal the assessee did not seriously canvas the question of goodwill and the issue was held against the appellant-assessee. The Tribunal took the view that the question, whether there has been a gift of a share by the assessee in the goodwill of the firm, would depend on whether the value of the assets of the firm exceeded its total liabilities. Since there was no material on this aspect of the matter, it would normally be necessary to remand the matter, but since the assessee was liable to succeed on another contention there was no need to remand the matter to the Assessing Officer. The Tribunal took note of the fact that the incoming partner, Smt. M.U. Indira, had contributed Rs. 25,000 as her share of the capital; the usefulness of her service to the firm had not been disputed by the Revenue.

Though the Revenue was of the view that the incoming partner had been given her share only on account of the reduction of the share of the appellant, it was only partly true. The Tribunal pointed out that it was not a case of mere reduction of the share of the appellant, the difference being allotted to the incoming partner, but it was a case of complete realignment of the shares of all the partners consequent upon reconstitution of the firm and that unless and until interest of the concerned partner is ascertained and quantified it could not be said that the consideration for transfer is adequate or not. Relying upon the judgment of this Court in ***Sunil Siddharthbhai v. Commissioner of Income-tax, Ahmedabad [156 ITR 509],*** the Tribunal held that even though there was a transfer by the assessee in favour of the incoming partner and the existing partners, inasmuch as the consideration for the transfer, which is the right to get the value of his share for the partner, cannot be valued during the subsistence of the partnership, it was not possible to consider and quantify the question of adequacy or inadequacy of consideration. In such an event, it could not be held that there was any gift exigible to tax.

6. The Revenue sought for and obtained a reference of the following two questions to the High Court under Section 26(1) of the Gift Tax Act. The two questions referred to the High Court were :

"1. Whether on the facts and in the circumstances of the case the Tribunal is right in law and fact in holding that even though the reconstitution of the firm resulted in the reduction of the share of profit of the assessee-trust, there was no gift exigible to tax in its hands ?

2. Whether, on the facts and in the circumstances of the case the Tribunal is right in law and fact in holding that even though there was a transfer by the assessee in favour of the incoming partner and existing partners, the consideration for the transfer could not be evaluated during the subsistence of the partnership and so the question of adequacy or inadequacy of consideration could not be quantified and so there was no gift exigible to tax ?"

7. The High Court answered the questions in the negative and against the assessee. The Assessee is in appeal by special leave.

8. The learned counsel for the appellant-assessee urged two contentions. First, that in view of the judgment of this Court in Sunil Siddharthbhai case (supra), as the value of the share of the partnership cannot be ascertained as on the date of induction of the new partner, and since the adequacy or inadequacy of consideration cannot be quantified, the same cannot be exigible to tax. Second, in any event, on reconstitution of the partnership, where there is contribution of capital by a new partner and consequent readjustment of the shares of the profit/loss of the existing partners, it does not result in a taxable gift since it was obligatory on all the partners to participate in the business and do the work of the firm which, taken together with the contribution made by the incoming partner, was adequate consideration.

9. Learned counsel for the Revenue however, contends that the judgment of this Court in Sunil Siddharthbhai case (supra) is distinguishable as applicable only to a situation falling under Section 45 read with Section 48 of the Income Tax Act, 1961 and in any event the judgment of this Court in ***Commissioner of Gift Tax Gujarat v. Chhotelal [166 ITR 124]*** this Court has found that even in such a situation the readjustment of the shares of the profit/share amounts to a taxable gift.

10. In Sunil Siddharthbhai case (supra) the assessee was a partner of a firm and he made over to the firm certain shares in a company which were held by him. These were credited to the partner's capital account in the book of the firm. The question was whether there was any capital gain which

resulted from the transfer of the shares held by the partner to the firm as its capital contribution and whether there was any transfer, within the meaning of Section 24 of the Income Tax Act, 1961, of the shares contributed by the partner as capital to the firm. This Court opined that when a partner brings in his personal assets into the partnership firm as his contribution to the capital he reduces his exclusive rights to the assets with the other partners of the firm. Although he may not lose his right in the assets altogether, he enjoys thereafter an abridged right which cannot be identified with a full right which he enjoyed in the assets before it was thrown into the partnership capital. The assets which were originally subject to entire ownership of the partner become subsequently subject to the rights of the other partners in it. To that extent this Court held that there was a transfer of the assets. On the question as to whether there was capital gain this Court was of the view that the evaluation of a partners interest takes place only upon dissolution of the firm or upon his retirement therefrom. What was the exclusive interest of the partner in his personal asset upon its introduction into the partnership firm transforms into the interest shared with the other partners in that asset. Qua that asset, there is a shared interest. During the subsistence of the partnership, the value of the interest of each partner qua that asset cannot be isolated or carved out from the value of the partner's interest in the totality of the partnership assets. And in regard to the latter, the value will be represented by his share in the net assets on the dissolution of the firm or upon the partner's retirement. It was, hence, held :

"Having regard to the nature and quality of the consideration which the partner may be said to acquire on introducing his personal asset into the partnership firm as his contribution to its capital, it cannot be said that any income or gain arises or accrues to the assessee in the true commercial sense which a businessman would understand as real income or gain."

11. Learned counsel for the Revenue relied on the judgment of this Court in ***Commissioner of Gift Tax, Gujrat v. Chhotalal Mohanlal [166 ITR 124].*** In that case a partner of a partnership firm having retired, two minor sons of an existing partner were admitted to the benefits of the partnership. This Court held that relinquishment of the share of an existing partner in favour of the minors who are admitted to the benefits of the partnership without any consideration amounted to a gift by the said partner in favour of the minors. The reason was that the goodwill of the firm is the property of the firm, and, upon admission of the two minors to the benefits of the partnership, the right to the money value of the capital stands transferred. Since this transfer is without consideration, insofar as minors are concerned, the transaction would amount to a taxable gift under the gift tax.

12. The judgment of this Court in ***B.T. Patil and sons v. Commissioner of Gift Tax [247 ITR 589]*** is also pressed into service by the learned counsel for the Revenue. This was a case where the assessee partner transferred certain items of machinery to each of its five partners and debited their accounts with the consideration charged therefor. The consideration was on the basis of the written-down value of the machinery in the books of accounts. Within a short time the partners floated another partnership and brought in the said machinery as their capital contribution thereto at a value which was almost three times the written down value. The newly floated partnership sold the machinery to another concern for a still higher price. The Gift Tax Officer held that the assessee firm had made a gift of the machinery to each of its five partners for inadequate consideration and, therefore, the transaction was assessable to gift tax. This Court distinguished the judgment in Sunil Siddharthbhai (supra) and held that when there is a dissolution of partnership or a partner retires and obtains in lieu of his interest in the firm an asset of the firm, no transfer is involved for the reason set out in the passage quoted above. But the position is very different, when, during the subsistence of a partnership, an asset of the partnership becomes the asset of only one of the partners thereof;

there is, in such a case, a transfer of that asset by the partnership to the individual partner. Where such transfer is for less than the value of that asset, there is a deemed gift to the extent of the difference under the provisions of Section 4(1)(a) of the Gift Tax Act, 1958. Learned counsel for the Revenue contended that what was said by this Court in B.T. Patil case (supra) was equally applicable to the case of the present appellant before us.

13. Although it may be possible to say in the appellant's case that relinquishment of the share of a profit/loss by a partner in favour of the inducted partner may amount to a transfer, we are unable to accept the contention that it was for inadequate consideration so as to amount to a taxable gift within the meaning of Section 4(1)(a) of the Gift Tax Act. The learned counsel for the assessee has drawn our attention to the judgment of the Karnataka High Court in ***D.C. Shah v. Commissioner of Gift Tax, Karnataka [134 ITR 493].*** That was also a case where, upon reconstitution of the firm, an incoming partner who contributed certain amount of capital was given a share in the partnership which was relinquished in his favour by an existing partner. The High Court held that having regard to the nature and constitution of a firm and the implication of the judgment of the Supreme Court in ***Gheevarghese case [1972 ITR 83, 403]*** a mere reallocation of shares would not result in a gift. The fact that there was some contribution by the incoming partners coupled with the obligation under the partnership deed upon the incoming partner to participate in the business and work for it diligently would constitute adequate consideration. There was an obligation upon all the partners to work for the progress of the business, albeit for administration convenience or overall guidance one of them might have been nominated as a managing partner, but that does not mean that the service to be rendered by other partners was either negligible or in any way diminished or could be left out of account. Hence, it was held that there was adequate consideration for the transfer by way of reallocation of shares. The judgment in DC Shah (supra) came to be appealed to this Court at the instance of the Revenue. The appeal came to be disposed of by this Court by a judgment in Civil Appeal Nos. 4551-56 of 1984 on September 25, 1996, wherein it was held "that the share of one partner is decreased and that of another partner correspondingly increased does not led to the inference that the former had gifted out to the latter. The profit sharing ratio in a firm can vary for a number of reasons, among them the ability of partners to devote time to the business of the firm. The gift of a partner's share to another partner has to be established by relevant evidence. The onus of doing so is on the Revenue. It has not been discharged in the present case".

14. The facts found in the present case are that the incoming partner (M.U. Indra) had contributed Rs. 25,000 towards her share of the capital. The value of her services or usefulness to the firm as partner has not been disputed by the Revenue authorities. As pointed out by this Court in D.C. Shah case (supra), the mere fact that upon reconstitution of the firm the share of one partner decreased and that of another increased cannot lead to the inference that the former had gifted the difference to the incoming partner. There is no other material placed on record by the Revenue to show that, in the facts and circumstances of the case, particularly taking into consideration the obligations of all the partners in the partnership deed dated 1.10.1982, there was inadequate consideration for the reallocation of 12% of the share in favour of the incoming partner. In our view, the contribution of Rs. 25,000 towards the capital together with the obligations undertaken of sincerely and faithfully carrying on the business for common advantage of the firm was adequate consideration for reallocating the share of the profits and giving 12% of the share in favour of the incoming partner M.U. Indira. That C.K. Jinan was the managing partner and C.N. Purushuthaman was the administrative head, did not take away the obligations of the other partners including those of M.U. Indira which arose generally under the Partnership Act, as well as under the partnership deed dated 1.10.1982.

15. We are of the view that even assuming that there was a transfer of 12% of the share profit/loss in favour of the incoming partner M.U. Indira by the appellant assessee, it was not a situation of transfer for inadequate consideration so as to amount to a taxable gift within the meaning of Section 4(1)(a) of the Gift Tax Act, 1958.

16. In the result, we answer the question no. 1 against the Revenue and in favour of the assussee. In view of our answer thereto, it is not necessary to answer the second question. The appeal is accordingly allowed and the judgment of the High Court is set aside. There will be no order as to costs.

Appeal allowed.