CALCUTTA HIGH COURT

Commissioner of Income-tax

Vs.

Chunilal Prabhudas

Income-tax Reference No. 39 of 1967

(P.B. Mukharji and Sabyasachi Mukharji, JJ.)

11.09.1969

JUDGMENT

P.B. Mukharji, J.

1. The statement of the case raises the following question for an answer by this Court :-

> "Whether on the facts and in the circumstances of the case the Tribunal was right in holding that no capital gains could arise under Section 12-B of the Indian Income-tax Act, 1922 out of the transfer by the firm of its assets and goodwill to the two private limited companies?"

2. Before proceeding to answer this question it will be appropriate to reframe the question by dropping the words "assets and" from the question because no argument has been advanced before us either on behalf of the assessee or the Commissioner on assets other than goodwill. The controversy is confined in this case only to goodwill and nothing else. In fact, no question arises with regard to other assets from the order of the Tribunal. The question re-framed, therefore, for the answer by this Court is as follows :-

> "Whether on the facts and in the circumstances of the case the Tribunal was right in holding that no capital gains could arise under Section 12-B of the Indian Income-tax Act, 1922 out of the transfer by the firm of its goodwill to the two private limited companies?"

3. The facts giving rise to this question are as follows : The assessment year is 1957-58 with the corresponding accounting year ending on 3-11-56. During this accounting year the assessee was a registered firm of six partners deriving income from import and export business. Its head office was in Calcutta and two branches in Bombay. On the very last day of this accounting year the assessee transferred its assets and liabilities and also the goodwill of its Calcutta business to a private limited company under the name Messrs. Chunilal Prabhudas and Co., Calcutta Private Ltd. and the assets and liabilities and also the goodwill of its Bombay business to another company under the name Messrs. Chunilal Prabhudas and Co., Bombay Private Ltd. These

transfers were made by two registered deeds both dated the 3rd November 1956, The assessee valued its goodwill for the Calcutta business and the Bombay business at Rs. 60,000/- each and received the total amount of Rs. 1,20,000/- in respect of the transfer of such goodwill. About the composition of the two companies to which this transfer was made the fact is that there were altogether 13 shareholders in the two companies consisting only of the six partners and their sons and wives. The consideration for the goodwill of the firm was not paid in cash but was paid for by the two companies by allocation of companies' shares representing the share of the each partner. In other words, the shareholder got as many shares of the company as his share in the partnership would justify. These are the basic and relevant facts.

4. The Income-tax Officer included the entire amount of this sum of Rs. 1,20,000/- allocated towards the goodwill of the firm as the firms' capital gain under Section 12-B of the Income-tax Act, 1922. The Income-tax Officer rejected the assessee's contention that the goodwill being an intangible asset did not come within the definition of a capital asset in Section 2(4A) of the Income-tax Act, 1922. The assessee could not satisfy the Income-tax Officer regarding the value of the goodwill as on 1-1-54 and the Income-tax Officer, therefore, was of the opinion that the acquisition of goodwill did not cost the assessee anything. The Income-tax Officer, therefore, held that the entire amount of Rs. 1,20,000/-was to be assessed as the assessee's capital gains. On appeal the Appellate Assistant Commissioner remanded the case to the Income-tax Officer for ascertaining the value of the goodwill of the firm as on 1-1-54. In answering the remand the Income-tax Officer reported that on the basis of the two years' purchase price of the average profits for the immediately preceding five years the value of the goodwill would amount to Rs. 73,886/- on 1-1-54. On the basis of that report, the Appellate Assistant Commissioner reduced the amount of capital gains to Rs. 46,114/-. It must be noted here that the Appellate Assistant Commissioner rejected all the contentions raised by the assessee that the excess value of the goodwill could not be assessed as the assessee's capital gains. The assessee thereafter appealed to the Tribunal. The contention raised before the Tribunal was that the shareholders of the company and the partners of the firm being more or less identical, the transfer of the firm to the company could not be regarded as a commercial transaction and no profits or gains could be said to arise out of such transfer. The Tribunal followed the case of the *Commissioner of Income Tax, Calcutta v. Mungneeram Bangur and Co*[1]*.,* and certain decisions of other High Courts relied on by the assessee before the Tribunal and held that the transfer by the firm of its goodwill to the two private limited companies did not amount to a commercial transaction and no assessable profits or gains could be said to arise out of such transfer. The result followed and the Tribunal directed the deletion of the amount of Rs. 46,114/- assessed as capital gains of the assessee firm for the assessment year 1957-58. The Commissioner thereupon asked for this reference finally resulting in the statement of the case raising the question quoted above.

5. The argument for the Revenue In this case is briefly this : Section 2(4A) of the Income-tax Act, 1922 defines capital asset as meaning "property of any kind held by an assessee whether or not connected with his business, profession or vocation". The definition excludes certain properties to which I shall make a reference later on. The contention on this point for the Revenue is that the residuary expression used in this section "property of any kind" includes goodwill which is a kind of property. The second step in the argument advanced by the Revenue is that under Section 12-B of the Income-tax Act there has been in this case a sale or a transfer or exchange or relinquishment of a capital asset producing

[1](1963) 47 ITR 565 (Cal)

profits or gains within the meaning of the Section. Therefore the Tribunal was wrong in holding "that the transfer by the firm of its assets and goodwill to the two private limited companies did not amount to a commercial transaction and no assessable profits or gains could be said to arise out of such transfer."

6. The answer to the question depends on the proper interpretation of Section 12-B of the Income-tax Act. It will be necessary therefore first to examine and interpret that section before discussing the case law on the subject. The language of the statute is necessarily the primary guide.

7. In interpreting Section 12-B of the Income-tax Act it will be necessary to bear in mind that goodwill is not an expression used in any of the sections of the Income-tax Act. If therefore goodwill has to be taxed it has to be found by necessary implication as taxable under one or other section of the Income-tax Act. It will be equally essential to remember that there can be no tax by analogy or by implication. With these remarks I shall now proceed to examine and construe Section 12-B of the Incometax Act.

8. Section 12-B (1) has for its marginal note the expression "capital gains". Capital gains were charged for the first time by the Income-tax and Excess Profits Tax Amendment Act, 1947, which introduced Section 12-B into the Income-tax Act, a tax on capital gains arising after the 31st March 1946. This levy was for all practical purposes abolished by the Indian Finance Act 1949, which confined the operation of this section to capital gains arising before the 1st April 1948. It was revived and resurrected with effect from 1st April 1957 by the Finance Act 1956 which substituted the present Section, which, inter alia, reads as follows :

> "12-B(i). The tax shall be payable by an assessee under the head capital gains in respect of any profits or gains arising from sale, exchange, relinquishment or transfer of a capital asset effected after the 31st day of March 1956 and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange or relinquishment or transfer took place."

It is followed by certain provisos to which I shall come later.

9. The expression capital asset in Section 12-B according to the definition of Section 2(4A) as already noticed, means property of any kind, but it expressly does not include –

> (i) any stock in trade, consumable stores or raw materials held for the purpose of business, profession or vocation;
> (ii) personal effects that is to say movable property including wearing apparel, jewellery, furniture held for personal use by the assessee or any member of his family dependent on him;
> (iii) any land from which the income derived is agricultural income."

In this kind of definition of capital asset in Section 2(4A), if the exclusion of the different types of properties mentioned under the three heads is any index or indication of the intention of the

legislature, then the type or nature of exclusion would seem to indicate that Parliament was thinking only of tangible properties like stock in trade, personal effects or land from which agricultural income was derived. The question is whether goodwill is a capital asset within the meaning of this definition of Section 2(4A) of the Income-tax Act. Revenue contends that it is, because the definition really is inclusive and has the residuary ambit including property of any kind except those which are excluded. This definition in Section 2(4A) is, as usual prefaced by the celebrated expression 'unless there is any thing repugnant to the subject or context'. Question, therefore, will be also whether inclusion of goodwill within the meaning of capital asset specially for the purpose of Section 12-B of the Income-tax Act would not be repugnant in the subject or context. Before proceeding to analyse the actual language of Section 12-B, it will be necessary also to refer to one other section apart from Section 2(4A) of the Act.

10. Income-tax is said to be a misnomer, because under the Income-tax Act it is not necessarily or only dealing with tax on incomes. It taxes many other things which can hardly be called income as understood in the popular or usual sense. Income in Section 2 (6c) (vi) of the Income-tax Act is said to include inter alia expressly - "any capital gain chargeable under Section 12-B." Therefore, a capital gain under Section 12-B is income within the meaning of the Indian Income-tax Act.

11. But the question then finally boils down to this whether goodwill is a "capital asset" within the meaning of Section 12-B of the Income-tax Act 1922 read with Section 2(4A) of the Act. In order to be taxable capital gain within the meaning of Section 12-B of the Income-tax Act, there have to be four primary tests, namely, (1) profit or gain, (2) capital asset, (3) arising out of and (4) "sale, exchange and relinquishment or transfer."

12. It is difficult to apply these tests to the case of goodwill. Goodwill fails in the test of capital asset. To begin with goodwill is not any kind of usual capital asset with which a business is started. It is not a capital asset which can be divided into parts, fragments or fractions or entered on the Stock book or register of capital assets nor can it like capital asset exist independently without the business itself and have any value apart from business usually associated with capital asset. Unlike capital assets goodwill as an asset is indivisible and cannot be sold, transferred or dealt with in fragments or fractions. On the interpretation of Section 2(4A), Section 2(4C) and Section 12-B and on their express words and tenor, goodwill does not come within the obvious meaning of capital asset. To bring goodwill within the meaning of capital asset and make it taxable would be to tax by implication or by analogy, or by a forced and artificial construction. There is neither any express provision nor any necessary implication which brings goodwill within the meaning of "taxable capital gains" under Section 12-B of the Income-tax Act. On the second test about profit or gains arising in connection with a sale or exchange or relinquishment or transfer many questions arise. In the first place, there may be a sale or exchange or relinquishment or transfer but if it does not produce any profit or gain then there would be no taxable capital gains within the meaning of Section 12-B of the Income-tax Act. It is not a question of whether the particular transaction is a trading transaction or not a trading transaction. There can certainly be capital gains outside the trading transaction so long as it satisfies the test laid down in Section 12-B. But the primary question is in the present circumstances whether there is any profit or gain. Assuming that there has been a sale or an exchange or a relinquishment or a transfer in the present case, the question still remains, has this transfer produced any profit or gain?

13. It will be necessary here at this stage to examine the agreement which is a part of the statement of the case and the records of this reference. It is called the Memorandum of Agreement dated the 3rd November 1956. It is between the vendor which is expressly said to include collectively the partners of the firm described as "the sole co-owners and co-proprietors thereof", on the one hand and the comapany as the purchaser on the other band. It recites, inter alia, the object of the company in these terms :-

> "To acquire the business hitherto carried on in Partnership under the firm name and style of Messrs. Chunilal Prabhudas and Co., together with the goodwill, import-export quota rights and other rights and privileges and assets and liabilities as a going concern to the extent of only the business of the firm conducted by the firm's office and for that purpose to enter into, execute and effectuate an agreement with the said partners of that firm and also to acquire any other business of any firm, person or company as may be found conducive to the interest of the company."

The recitals of the agreement refer "to absolutely transfer and convey and give and offer delivery of possession of the said partnership business together with all its assets and liabilities, its entire goodwill including the benefits of the existing and/or the unexpired contracts and agreements import and export quota rights, permits or licenses together with the entire liabilities as a going concern to the said limited company". The recitals also use the expression "to completely and absolutely acquire and succeed to the business firm, the entire goodwill and rights, privileges as well as the liabilities of the said vendor under the said entire partnership business as a going concern". It is also provided in the agreement, inter alia, "the payment of the said amount of Rs. 60,000/- shall be made by the purchaser to the vendor by issue and allotment of 600 fully paid up shares of the total value of Rs. 60,000/- only in the share capital of the purchaser company to the said six above named parties collectively composing the vendor or to their individual respective nominees and said fully paid up shares shall be accepted by the vendor as reasonable and adequate consideration and in full settlement of its their joint and/or several rights, title or interests in the goodwill of the said vendor and its/their business and firm styled as Chunilal Prabhudas and Co." Finally clause 7 of the agreement provides, "the purchaser company shall have the sole and exclusive right of use and own the name Chunilal Prabhudas and Co. in connection with the said business or any other business or businesses and/or for any other purposes whatsoever as the purchaser company from time to time initiate, run or develop, or may decide upon."

14. On these facts the question is, is this transfer producing any profit or gain for practical purposes or even for legal notion? There is no obvious profit or gain in money or material. The shares of the partners are converted into shares of the company. No money in cash or in kind passes according to ordinary or even remote acceptation of these terms. It is a kind of a conversion of partners' share into a shareholders' share. It is at best a transformation of one kind of property into another. If for an equivalent amount of money paid, a cheque for the same amount of cash given is issued, or vice versa, then there is no capital gain producing no profit or gain within the meaning of Section 12-B of the Income-tax Act, 1922.

15. It will be necessary now to come back to the interpretation of Section 12-B of the Income-tax Act, in greater detail. The first two provisos of the first sub-section of Section 12-B are

significant. The first proviso, inter alia, exempts distribution of capital assets on the total or partial partition of a Hindu undivided family or under deed of gift, bequest or will which is expressly said to be not sale or exchange or relinquishment or transfer of capital assets. The second proviso exempts in a sense the transfer of a capital asset by a company to a subsidiary, the whole of the share capital of which is held by the parent company or by the nominees thereof and that is expressly said to be not a sale, exchange or transfer within the meaning of this section. These two provisos under sub-section (1) of Section 12-B of the Income-tax Act, 1922 do not make it clear either expressly or by necessary implication that goodwill was at all a contemplated subject of taxable capital gain within the meaning of the section. On the contrary, if the first proviso is taken off Section 12-B(1) many undivided Hindu families may have joint family businesses of great goodwill and obviously the transfer of such a goodwill of a Hindu undivided family under a partition would not be a capital gain. To include goodwill as taxable capital gain within the meaning of Section 12-B of the Income-tax Act would then be to discriminate between the transfer of the goodwill of a Hindu family business in the case of a partition of a Hindu undivided family which will not be taxable capital gain under Section 12-B and transfer of the goodwill of other kinds of businesses such as belonging to partnerships or companies. It is an inherent indication that goodwill as such was not intended to be a taxable capital gain within the meaning of Section 12-B of the Income-tax Act. Otherwise the incongruous and illogical distinction would arise that goodwill transferred in the case of partnership or company will be taxable capital gain but not goodwill transferred in the case of partnership (sic) (Hindu undivided family). That could not have been the intention of Parliament.

16. Proceeding further with the interpretation of Section 12-B, a glance at sub-section (2) of Section 12-B indicates the principles of deduction. Sub-section (2) of Section 12-B provides how the amount of a capital gain shall be computed after making certain deductions from the value of the consideration for which the sale or exchange or relinquishment or transfer of the capital asset is made. Looking at the list of deductions, as for instance in Section 12-B(2) (i) there is, "expenditure incurred solely in connection with such sale, exchange, relinquishment or transfer". It means that only that deduction is allowable which is in respect of an expenditure incurred solely for this purpose. Can there be an expenditure in this connection for transfer of goodwill which can be separated from other expenditure to say that this is an expenditure incurred solely for the transfer of goodwill? The answer can only be in the negative. Again in sub-clause (ii) of Section 12-B(2) there is the mention of the actual cost to the assessee of the capital asset including any expenditure of a capital nature incurred and borne by him in making additions or alterations thereto. It is difficult to imagine from the practical point of view or even in legal notion how there can be an expenditure which will separate the actual cost of a goodwill in the assessee's capital asset and particularly for making any addition or alteration to such goodwill. These are compelling considerations which appear to exclude goodwill from the concept and ambit of Section 12-B of the Income-tax Act.

17. Finally, coming to the different provisos in sub-section (2) of Section 12-B dealing with the valuation of the capital asset with reference to the fair market value on the date of sale or exchange or relinquishment or transfer and providing even, as in the third proviso, for substitution for the actual cost, such fair market value, appear to militate against any interpretation which includes goodwill within its ambit. The "actual cost" in the case of goodwill seems to me to be an incongruous expression to be applicable to the case of a goodwill.

18. On the basis of this interpretation and construction of Section 12-B of the Income-tax Act and its various sub-sections and provisos I am of the opinion that goodwill does not come and was not intended to come within its ambit as taxable capital gains.

19. Whether property can be tangible or intangible is not a consideration which goes into our decision in this matter in coming to the conclusion just stated. It is well-known in property jurisprudence that property can be intangible. Right of easement is an intangible property. May be there are also certain other properties with similar or comparable characteristics like patent, trade mark or copyright.

20. But the fundamental point is that goodwill basically is reputation. Reputation as such is not taxable unless it can come within certain objective standardization producing either income or capital gain. There can be no sale of a goodwill without the business associated with that goodwill or the name. From that point of view goodwill has no separate existence apart from business. One cannot sell the goodwill and retain the business that the goodwill represented, nor can one sell the business and retain the goodwill. On this point see the observations of the Supreme Court in *Jogta Coal Co. Ltd. v. Commr. of I.T., West Bengal*[1], and *S.C. Cambatta and Co., Ltd. v. Commr. of Excess Profits Tax, Bombay*[2], quoting Lord Macnaghten in *Inland Revenue Commr. v. Muller and Co.'s Margarine Ltd*[3]., to which reference will presently be made and where Lord Macnaghten emphasised that "goodwill has no independent existence. It cannot subsist by itself. It must be attached to business".

21. In addition to the principles of construction, there is the authority of a Division Bench of the Madras High Court in *Commissioner of Income Tax, Madras v. K. Ratham Nadar*[4], which supports the conclusion to which we have arrived. It is an authority for holding that Section 12-B(2) (ii) of the Income-tax Act, 1922 suggests that capital gain arises only on the transfer of a capital asset which has actually cost to the assessee something and that such actual cost in the context of the Income-tax Act is cost in terms of money and it cannot apply to transfer of capital assets which did not cost anything to the assessee in terms of money in its creation or acquisition. The present reference stands on the stronger footing than that. In that case there was cash consideration for the goodwill but here there is only substitution of the partner's share in the company's share without any cash or without any money from the ordinary point of view. After an exhaustive review of the nature of goodwill, found in different authorities and cases and a comprehensive survey and analysis of the section of the Income-tax Act, the learned Judges of the Madras High Court came to the conclusion at pages 449-450 where the Court expressed its views in the following terms :-

> "We have, therefore, to proceed on the basis that, while the British and the American taxation laws proceed on the footing that capital gains are assessable in

[1]36 ITR 521 at p. 524 : (AIR 1959 SC 1232 at p. 1234)

[3]1901 AC 217

[2]41 ITR 500 at p. 504 : (AIR 1961 SC 1010 at p. 1012)

[4](1969) 71 ITR 433 (Mad.)

> the case of transfer of goodwill, but the Indian Act did not have in contemplation, when enacting the Section 12-B, that self-created assets like copyrights, patents and goodwill should be subjected to capital gains arising on their transfer. It is enough to say that, complex and difficult as this question is, we are not satisfied that either the Legislature intended to include property of the kind now in question for the purpose of

> taxation of capital gains, or that the wording of Section 12-B supports such a contention. We, therefore, hold, though not without hesitation, that capital gains on the transfer of goodwill are not liable to be taxed under Section 12-B."

I shall refer to one other decision on this point of the Allahabad High Court in *Gangadhar Baijnath v. Commr. of I.T., Lucknow*[5], The third question for an answer in that case as reported at p. 631 of that report was "whether on the facts and circumstances of the case the receipt of Rs. 35,01,000/-was taxable under Section 12-B of the Income-tax Act." M. C. Desai, C. J. delivering the judgment for the Bench at p. 646 of the report observed as follows :-

> "There is no question of applying the doctrine of substance because the act purporting to have been done, could not only have been done physically, but also could have been done lawfully. For the purpose of Section 12-B one must consider the form of transaction, though for the purpose of deciding whether the receipt is a capital receipt or the Revenue income, one might consider the substance. In *Bankey Lal Vaidya v. Commr. of I.T*[6]*.,* to which I was a party it was decided that when one partner of the dissolved partnership takes up the entire business and pays the retiring partner the price of his share, the price received by the latter is not a capital gain. My answer to question No. 3 is, therefore, in the negative and in the assessee's favor."

22. These are the direct authorities on Section 12-B of the Income-tax Act. But the question of course has come up incidentally or collaterally when Courts have considered other sections of the Income-tax Act such as Section 10(2) (xv) of the Income-tax Act, 1922, dealing with profits and gains of business and allowances for expenditure of a residuary nature, but not being in the nature of capital expenditure or personal expenditure laid out or expended wholly or exclusively for the purpose of the said business. Lord Bowen in City of *London Contract Corpn. Ltd. v. Styles*[7]*,* at p. 243 expressed the view that money expended not for the purpose of carrying on a concern, but to acquire the concern is a capital expense. It is, significant that in that case money was paid by a Limited Company to buy the business of a firm and that was held to be a capital gain. The Privy Council in *Tata Hydro-Electric Agency Co. Ltd. v. Commissioner of Income Tax*[8]*,* came to the conclusion that payment made in consideration of the acquisition of the right to earn profits, that is, of the right to conduct the business and not for the purpose of producing profits, could not be allowed as a deduction in such cases. All these authorities were concerned really with the question of acquiring the concern or goodwill or the right to earn profits under Section 10(2) (xv) or similar provision on the point of capital or revenue expense and these authorities did not turn really on the interpretation of Section 12-B of the Income-tax Act.

[5](1966) 60 ITR 626 (All) [7](1887) 2 Tax Cas 239
[6](1965) 55 ITR 400 (All) [8]5 ITR 202

23. It will be unnecessary for us to discuss at length the numerous cases and authorities on goodwill and its legal character and incidents. They will be found in some of the judgments of the Supreme Court and other High Courts which we have quoted above and also of Division Bench decision of this Court to which I was a party in *Dulal Das v. Ganesh Damani*[9] It is, however, necessary to refer to the case of a Division Bench of this Court in (1963) 47 ITR 565 (Cal) relied on by the Tribunal in this case. The difficulty is that this is not a case where the decision was given with reference to Section 12-B of the Income-tax Act, 1922. It, however,

contained an observation at p. 585 "if there cannot be a sale by a person to himself for Income-tax purposes, there can equally be no transfer of goodwill by a person to himself". This decision went up to the Supreme Court which affirmed it but not on the ground of a transfer by a person to himself, but on the ground that there was no profit shown or proved.

24. Goodwill has been variously described. It has been horticulturally and botanically viewed as "a seed sprouting" or an "acorn growing into the mighty Oak of goodwill". It has been geographically described by locality. It has been historically explained as growing and crystallizing traditions in the business. It has been described in terms of a magnet as the "attracting force". In terms of comparative dynamics, goodwill has been described as the "differential return of profit." Philosophically it has been held to be intangible. Though immaterial, it is materially valued. Physically and psychologically, it is a "habit" and sociologically it is a "custom". Biologically, it has been described by Lord Macnaghten in *Trego v. Hunt*[10], as the "sap and life" of the business. Architecturally, it has been described as the "Cement" binding together the business and its assets as a whole and a going and developing concern. It has been Zoologically explained by Rich, J. in *Federal Commr. of Taxation v. Williamson*[11], quoted at pp. 39-40 of the 4th Edition of "The Valuation of Company Shares and Business" by Adamson and Coorey in these terms :-

> "In *Whiteman Smith Motor Co. v. Chaplin* the types were zoologically classified into cats, dogs, rats and rabbits. The cat prefers the old home to the person who keeps it and stays in the old home although the person who has kept the home leaves and so it represents the customer who goes to the old shop whoever keeps it and provides the local goodwill. The faithful dog is attached to the person rather than the place, he will follow the outgoing owner if he does not go too far. The rat has no attachments and is purely casual. The rabbit is attracted by mere propinquity. He comes because he happens to live close by and it would be more trouble to go elsewhere. These categories serve as a reminder that the goodwill of a business is a composite thing referable in part to its locality, in part to the way in which it is conducted and the personality of those who conduct it and in part to the likelihood of competition, many customers being no doubt actuated by mixed motives in conferring their custom."

25. In the Division Bench decision of this Court in 99 Cal LJ 11 at p. 15 : AIR 1957 Calcutta 280 at p. 282 this is what I observed :-

> "The law of goodwill is often misunderstood because I think jurisprudence not

[9] 99 Cal LJ 11 at pp. 15 to 18 : (AIR 1957 Cal 280 at pp. 282-83)

[11] 7 ATD 272

[10] 1896 AC 7

> infrequently treats it as an abstract notion, which in fact it is not. Goodwill must always be understood in relation to facts. Goodwill in jurisprudence is not the abstract quality which the grammarian means by that expression but a very concrete notion of great practical import. What the goodwill of a business is depends a good deal on the facts and circumstances of the particular business. Goodwill represents business reputation. Business reputation in my view is a complex of personal reputation, local reputation and

objective reputation of the products of the business. Which one of these elements will predominate will depend on the facts and circumstances of each case. Except where the reputation of a business and where the product of the business more than its proprietor have won widespread popularity and universal approval and except in the case of well-known patents and manufacturing processes in which event the personal and objective reputations predominate, it is the local reputation or the attribute of locality which forms the largest content of goodwill in almost every other business. Specially is the attribute of locality the most important consideration in the business of an ordinary trader or a dealer as in the present case. In my opinion, there can be no hard and fast rule, no simple formula and no inflexible and rigid definition of the term "goodwill" but in each case it is necessary to see the entire nexus of facts connected with the business whose good will is to be determined."

26. In this context Lord Macnaghten J. in 1901 AC 217 observed : "What is goodwill? It is a thing very easy to describe, very difficult to define."

In the same case, Lord Lindley observed as follows :-

> "Goodwill regarded as property has no meaning except in connection with some trade, business or calling. In that connection I understand the word to include whatever adds value to a business by reason of situation, name and reputation, connection, introduction of old customers and agreed absence from competition, or any of these things and there may be others which do not occur to me."

27. On appeal in *Commissioner of Income Tax v. Mungneeram Bangur*[12], the Supreme Court, in dealing with the question whether the vendor and the vendee were legal entities and whether it was permissible to tear the corporate veil to see whether the partners of the vendor were the same persons as the shareholders of the vendee, observed that it was not necessary to deal with those questions. That they are different legal entities or different juristic personalities when a partnership becomes a limited company has been copiously supported by many references cited from the Bar as *Salomon v. Salomon*[13]. Again in *Doughty v. Commr. of I.T*[14]*.,* the question was, two partners carrying on business in New Zealand sold their partnership business to a limited company in which they became the only shareholders. The sale was also of the entire assets including goodwill and the consideration was fully paid up shares in the company. The Privy Council came to the conclusion that if the transaction was to be treated as a sale, there was no separate sale of the stock and no valuation of it as an item forming part of the aggregate sold and that the transaction was a mere readjustment of the business position of the partners resulting in no profit and a mere book-keeping entry could not be taken as a conclusive evidence of profit.

[12] 57 ITR 299 at pp. 303-304 : (AIR 1966 SC 50 at pp. 52, 53)
[14] 1927 AC 327
[13] 1897 AC 22

28. But the case on which the greatest reliance was placed on behalf of the Revenue was on the Supreme Court decision in *Commissioner of Income Tax, Gujarat v. B.M. Kharwar*[15]*,* But here again this does not help the Revenue because this was a decision on Section 10(2) (vii) and not on Section 12-B of the Income-tax Act with which we are concerned. It deals with the doctrine of

the substance of the matter in relation to the form. At page 606 Shah J., who delivered the judgment for the Supreme Court observed :

> "The taxing authority is entitled or is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by a device the legal relation, it is open to the taxing authorities to unravel the device to determine the true character of the relationship. But the legal effect of a transaction cannot be displaced by probing into the substance of the transaction."

29. Again at page 608 Shah J., observed :

> "The company was a legal entity distinct from the partnership under the general law. Transfer of the machinery was by the firm to the company; and the legal effect of the transaction was to convey for consideration the rights of the firm in the machinery to the company. The transaction resulted in excess realisation over the written down value of the machinery to the firm and the liability to tax, if any, arising under the Act could not be avoided merely because in consequence of the transfer the interest of the partners in the machinery was substituted by an interest in the shares of the company which owned the machinery."

30. Having regard to the grounds on which we base our decision it will be unnecessary to discuss in detail the principles of that case as also in the case cited by the Revenue of *Commissioner of Income Tax, Calcutta v. Associated Clothiers Ltd*[16]*.,* affirmed by the Supreme Court in 63 ITR 224 .

31. We therefore consider it unnecessary to discuss in detail Mr. Banerjee's arguments for the assessee regarding the decision in 72 ITR 603 when Mr. Banerjee said that the decision did not notice the previous Supreme Court decision in 1954 in the case of *Liquidators of Pursa Ltd. v. Commissioner of Income Tax*[17]*,* regarding realization sale and West Coast Commercial case in 46 ITR 135 (SC) which approved and applied Doughty's case in 1927 AC 327 dealing with slump sale as well as the Supreme Court decision in Mungneeram Bangur's case which is reported in 57 ITR 299 and the previous Supreme Court decision in Morning Star case, (1967) 66 ITR 725 (SC). Mr. Banerjee has also contended that the observations in Kharwar case in 72 ITR 603 at p. 608 : (AIR 1969 Supreme Court 812 at p. 815) to the effect that it was not necessary for the purpose of the case and was apparently recorded without any debate on the question in Kikabhai's case was in fact not casual but the ratio itself for the decision of the Supreme Court in Kikabhai's case in 24 ITR 506 and he drew our attention to the principle and ratio in Kikabhai's case 24 ITR 506 at p. 509 : (AIR 1953 Supreme Court 509 at p. 510) of the report. In fact Mr. Banerjee drew our attention to a larger Bench decision of the Supreme Court of seven Judges in Bai Shirinbai K. Kooka, 46 ITR 86 at p. 91 : (AIR 1963 Supreme Court 477 at pp. 479-480) where the Full Bench affirmed the principle and the ratio in Kikabhai's case, 24 ITR 506 .

[15] 72 ITR 603

[17] 25 ITR 265

[16] AIR 1963 Calcutta 629

32. In the view that we are taking it will no longer be necessary to discuss the characteristics of the four different types of transaction, namely, (1) sale, (2) exchange, (3) relinquishment and (4) transfer in Section 12-B of the Income-tax Act. Here the sale or transfer or exchange or

relinquishment was to lead to the complete extinction of the partnership or the firm. The entire partnership with its goodwill was being taken over by the two limited companies. One of the points made before us is whether such a transaction could come within the meaning of either a sale or a transfer or an exchange or a relinquishment and whether when there is complete extinction there could be any further goodwill or transfer of the firm as a going concern. We prefer to rest our decision in this case on the authorities quoted above not on this branch of the argument at all but on the point that goodwill is not a capital asset within the meaning of Section 12-B of the Income-tax Act, 1922 and the further fact that it produced no profit or gain in this case in any event in the sense indicated above.

33. The answer to the question reframed by us is, therefore, in the affirmative and in favour of the assessee and I hold that goodwill is not and cannot be treated as capital gain within the meaning of Section 12-B of the Income-tax Act, 1922 and no capital gain arose within the meaning of Section 12-B of the Income-tax Act in respect of the goodwill. Each party would bear its own costs.
Sabyasachi Mukharji, J.

34. I agree.

Answered in favour of the assessee.