

# KERALA HIGH COURT

Commissioner of Income-Tax

Vs

Morning Star Bus Service

(P. Govinda Menon, J.)

18.02.1963

## JUDGMENT

**P. Govinda Menon, J.**

This is a reference by the Income-tax Appellate Tribunal, Madras Bench, under section 66(1) of the Indian Income-tax Act, 1922. The question referred is :

"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 ?"

The assessment year with which we are concerned of five members, was carrying on a bus transport business in the accounting period relevant to the assessment year.

On June 1, 1955, the members of the association formed a private limited company and transferred to that company the business and assets of the association. There were no shareholders other than the members of the association, and no assets other than those transferred by the association. The written down value of seven buses transferred to the company was Rs. 24,302. Their value, however, was entered in the books of the company as Rs. 70,000. The question for consideration is whether the difference between the two figures, namely, Rs. 45,698 is assessable to tax under the second proviso to section 10(2) (vii) of the Indian Income-tax Act, 1922.

Sub-section (2) of section 10 provides that the profits or gains of a business, profession or vocation should be computed after making the allowances specified therein. The allowance specified in clause (vii) of the sub-section is worded as follows :

"... in respect of any such building, machinery or plant which has been sold or discarded or demolished or destroyed, the amount by which the written down value thereof exceeds the amount for which the building, machinery or plant, as the case may be, is actually sold or its scrap value."

There are five provisos to clause (vii). The second of them is :

"Provided further that where the amount for which any such building, machinery or plant is sold, whether during the continuance of the business or after the cessation thereof, exceeds the written down value, so much of the excess as does not exceed the difference between the original cost and the written down value shall be deemed to be profits of the previous year in which the sale took place.

The effect of the proviso is clear : In cases where the sale proceeds plus the aggregate of the depreciation allowances already made exceed the original cost, the excess or the aggregate of the depreciation allowances, whichever is less, is taxable as profits. A company is a different legal entity from its shareholders. Its assets are not their assets; its debts are not their debts; and there can be no doubt that when the association of persons transferred the buses to the company on June 1, 1955, there was a "sale" in the strict legal sense of the term. The question for determination is whether it is in that strict and legal sense that the word "sale" is employed in the second proviso to section 10(2) (vii) of the Act. The identical question came up for consideration before the High Court of Bombay in *Rogers & Co. v. Commissioner of Income-tax*. Chagla C.J., delivering the judgment of the court, said :

"Now what are the facts and circumstances of this case ? We have a legal entity - the partnership firm consisting of eleven partners. We have a different legal entity constituted by the private limited company. undoubtedly, the two entities are different in the eye of the law, but - and it is an important but - the persons who constitute the two entities are identical. They are identical from a commercial point of view, because we fully understand the position that in the eye of the law a limited company is not the same as the shareholders of that company. But the persons who benefit by the profits made by the firm and the persons who benefit by the profits made by the limited company are identical and the profits made by the firm and the profits made by the limited company are shared by these persons in identically the same proportion. Mr. Joshi says that the sale contemplated by the second proviso to section 10(2) (vii) is a transfer of assets by one legal entity to another, and once there is a transfer for a price, in law there is a sale and the second proviso comes into play. If that be the true view to take of the expression sale used in the second proviso, then Mr. Joshi is undoubtedly right, because we have here a transfer of assets from one legal entity to another for a fixed price; and if nothing more is to be looked at except the purely legal position, then there can be no controversy and there can be no debate that for the purpose of the second proviso a sale has taken place, and in as much as the price received by the vendor exceeds the written-down value to the extent laid down in the second proviso, he is liable to pay the tax. But in all transactions which come up for consideration in a taxing statute we have to look at the real nature of the transaction; we have not to look at the form - the legal form - which a transaction has;

and when we look at the real nature of the transaction before us, although legally it is a sale, substantially and really it is only a readjustment made by certain persons so as to carry on business in one form rather than in another. Eleven persons are carrying on business as a firm. They are carrying on a particular activity and making profits. Those eleven persons make up their minds to readjust their business position and to carry on the identical business, the identical activity, by means of a limited company. The assets of the firm now belong to the company. No change has taken place except the legal change of a company taking the place of a firm. Under these circumstances, can it be said that there is a sale by the firm to the company which attracts the application of the second proviso to section 10(2) (vii) ?"

and answered the question in the negative. To the same effect is the decision of the Calcutta High Court in Commissioner of Income-tax v. Mugneeram Bangur & Co. We are in agreement with the view expressed by the High Court of Bombay and Calcutta, and answer the question referred in the negative and against the department. What the second proviso brings to charge is the profits 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 in the case before us, it cannot be said that the second proviso is attracted and that a tax liability does arise. We make no order as to costs. A copy of this judgment under the seal of the High Court and the signature of the Registrar will be forwarded to the Appellate Tribunal as required by subsection (5) of section 66 of the Indian Income-tax Act, 1922. Reference answered in the negative.