BOMBAY HIGH COURT

Rogers and Co

Vs.

Commissioner of Income Tax

Income Tax Ref. No. 84 of 1957

(M.C. Chagla, C.J. and S.T. Desai, J.)

24.03.1958

JUDGMENT

M.C. Chagla, C.J.

1. Messrs. Rogers and Co. carried on the busi***** of making aerated waters as a firm till the 6th of August 1949 and the partners of the firm were 11 in number. On the 6th of August 1949 this firm converted itself into a private limited company. The shareholders of this company were the same as the partners of the firm and the shares allotted to the shareholders were in the same proportion as the shares held by them in the partnership; the slight difference was due to the shares being rounded off to a specific number. The written-down value of the block assets of Messrs. Rogers and Co. in their books was Rs. 3,81,848/-. These assets were transferred to the limited company at the original cost price of Rs. 4,85,354/- and the Department contended that the limited company in thassessment year 1950-51 was liable to pay tax on the difference between Rs. 4,85,354/- and 3,81,848/- by reason of the second proviso to Section 10(2)(vii) of the Income-tax Act.

2. Turning to Section 10(2)(vii), it deals with depreciation and the second proviso is in the following terms :

> "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 only narrow question that we have to consider on this reference is whether on the facts and circumstances of this case it could be said that the building, machinery or plant was sold by the

firm of Messrs. Rogers and Co. to the private limited company of Messrs. Rogers and Co. Ltd. If there was a sale, then the second proviso is attracted and the assessee company is liable to pay tax on the difference between the written down value and the cost price.

3. 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 I 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 inasmuch 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 transactions; 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 readjustment of 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) ?

4. Now it is elementary that a person cannot sell to himself for the purpose of income-tax, because a person cannot make profit out of himself. The basic idea underlying Section 10(2)(vii) is that the vendor has made profit by the transfer of his assets. Mr. Joshi is right that profit is notional, but still it is a profit; and in order that the profit should be made, there must be two parties to the transaction - the vendor and the vendee - and the vendor must make profit by transferring his asset to a third party. If he transfers it to himself, he cannot make profit either real or notional. These principles which we are enunciating were very clearly and emphatically

enunciated in *Commr. of Inc.-Tax, v. Sir Homi Mehta's Executors*[1]; Mr. Joshi does not like those principles; but for good or for evil they are there till a higher Court tells us that they are not the correct principles which we laid down. Now that was a case where Sir Homi Mehta and his sons constituting a firm transferred certain shares to a private limited company. The shares were transferred of the value of Rs. 40 lakhs and the shares had originally cost Rs. 30 lakhs and the Department contended that the assessee must pay tax on the difference between Rs. 40 lakhs and Rs. 30 lakhs inasmuch as by transferring the shares to the company it had made a profit of the difference between Rs. 40 lakhs and Rs. 30 lakhs. We rejected this contention pointing out that though the assessee and his sons on the one hand and the private limited company

[1]1955-28 ITR 928

formed by them on the other were distinct entities in law, the real result of the formation of the company and the transfer of the shares to the company was only that, instead of the shares being jointly held as individuals, they were held by these very persons as a limited company; that the so-called sale of the shares to the company was not a business activity entered into with the object of earning a profit and was not really a sale, but merely a procedure adopted for readjustment of their position as holders of the shares and the assessee did not make any profit or gain in a commercial sense by transferring the shares to the company. These observations apply wholly to the facts of the present case. Here the assets, instead of being jointly held by the eleven partners, are held by the limited company. This so-called sale of assets is not a business activity; they are not sold in the course of the business; they are not sold to make profits; they are merely transferred as a procedure adopted for readjustment of the partners as owners of these assets. Now, how is this decision sought to be distinguished ? The only distinction suggested is that this was a case where the assessee was selling his stock-in-trade and the question was whether in transferring his stock-in-trade he had made profit, but instead of this, now that we are dealing with depreciation under Section 10(2)(vii), the principle that may apply to the sale of the stock-in-trade would not apply to the case of depreciation. Now, the importance of this decision - if it has any - is that we considered whether a particular transaction constituted a sale for the purpose of taxing law and we drew a distinction between sale in a technical, legalistic sense and sale from a commercial point of view as representing a real transaction. If that principle was correctly enunciated then we see no reason why it does not apply to the case of a sale under Section 10(2)(vii). It must apply to all cases of sale dealt with under the Indian Income-tax Act, unless there is something in the section itself which makes it clear that the sale contemplated by the Legislature is not only a sale where according to the real transaction, from the commercial point of view, it is a, sale, but even where it is a sale from a legal and technical point of view. Why are we to construe the expression "sale" in the second proviso in the wide manner suggested by Mr. Joshi ? Why are we to say that the assessees have made notional profits out of a transaction when in reality that transaction is nothing more than a readjustment of the position of the assessees quae their business ? There is no indication given by the Legislature that the expression "sale" in this second proviso should be construed, not from the point of view of the ordinary canon of construction laid down with regard to taxing laws, but according to some special canon of construction. In our opinion, if Sir Homi Mehta's case (AIR 1956 Bombay 415) correctly laid

down the law, then we must come to the conclusion that the transaction effected between the firm of Rogers and Co. and the private limited company was not a sale and if it was not a sale, the provisions of the second proviso are not attracted.

5. It must follow from our decision that, if there was no sale, then the mere book entry in the books of the company that the value of the assets of the firm taken over by the company was Rs. 4,85,354/- cannot have any Bearing on the question of the depreciation to which the limited company is entitled. If we are going to wipe off the sale for the purpose of the second proviso to Section 10(2)(vii) so that the limited company should not be liable to tax, it must equally be wiped of so as to prevent the assessee company from claiming depreciation on the basis that the value of these assets was Rs. 4,85,354/-. From a commercial point of view, the value of these assets continues to be Rs. 3,81,848/- notwithstanding this transaction. The entries made in the books of account do not represent the real nature of the transaction as far as the sale is concerned; and if they do not represent the real nature of the transaction in that sense, they equally do not represent the real transaction from the point of view of the price fixed for this transaction. Although for the purposes of the books of the firm and the company the price might have been fixed at Rs. 4,85,354/-, as we just said, the written-down value of the assets continues to be Rs. 3,81,848/-. We understand that the assessee company has claimed depreciation on the basis of the value of the assets being Rs. 4,85,354/- and we also understand that depreciation has been allowed by the Department on that basis. Mr. Palkhivala fairly concedes that he cannot have it both ways. If he can persuade us to hold that the Tribunal was wrong in the view that it took, it must follow that his clients were equally wrong in claiming depreciation on the basis that the value of the assets was Rs. 4,85,354/- and not Rs. 3,81,848/-.

6. We must answer the question submitted to us in the negative, Commissioner to pay the costs.

7. Mr. Palkhivala says that he has no objection to necessary proceedings being taken by the Department for the purpose of correcting the assessment of the assessee company under the appropriate provisions of the Act.
Reference answered.