

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD**TAX APPEAL NO.69 of 2003****FOR APPROVAL AND SIGNATURE:**

HONOURABLE MS. JUSTICE HARSHA DEVANI
and
HONOURABLE MR. JUSTICE A.G.URAIZEE

1	Whether Reporters of Local Papers may be allowed to see the judgment?	
2	To be referred to the Reporter or not?	
3	Whether their Lordships wish to see the fair copy of the judgment?	
4	Whether this case involves a substantial question of law as to the interpretation of the Constitution of India or any order made thereunder?	

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D.C.I.T.....Appellant(s)

Versus

R.L. KALATHIA & CO.....Opponent(s)

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Appearance:

MR MR BHATT, SR. ADVOCATE with MRS MAUNA M BHATT, ADVOCATE
for the Appellant(s) No.1

MS NIYATI K SHAH, ADVOCATE for the Opponent(s) No.1

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CORAM: **HONOURABLE MS. JUSTICE HARSHA DEVANI**
and
HONOURABLE MR. JUSTICE A.G.URAIZEE

Date : 08/01/2016

ORAL JUDGMENT
(PER : HONOURABLE MS. JUSTICE HARSHA DEVANI)

1. By this appeal under section 260A of the Income

Tax Act, 1961 (hereinafter referred to as “the Act”) the appellant - revenue has called in question the order dated 22nd October, 2002 made by the Income Tax Appellate Tribunal, Rajkot Bench (hereinafter referred to as “the Tribunal”) in I.T.A. No.2731/RJT/2000.

2. By an order dated 31st March, 2003, this appeal came to be admitted on the following substantial question of law:

“Whether on the facts and in the circumstances of the case the Income-tax Appellate Tribunal was justified in law in holding that the sale of business of firm as a going concern to the company for a consideration of paid up share capital does not amount to transfer liable to tax as capital gains?”

3. The assessment year is 1996-97 and the relevant accounting period is the financial year 1995-96. The assessee, a partnership firm, was engaged in the business of construction work as Builder/Developer/Contractor. The return of income came to be filed for the period relevant to assessment year 1996-97, wherein the assessee declared income of Rs.7,56,060/- a major part of which included profit from construction work. Along with the computation of income annexed to the return of income, balance sheet and list of fixed assets as per Schedule 4 were submitted.

4. In the note below the said Schedule 4 with regard to fixed assets, a note was given as below:

“2. Land has been revalued during the year and reserves created credited to Partner’s Capital A/c.

3. The firm was having Shopping Center at Sarita Society, Bhavnagar, the cost of which was not recorded in the

earlier year. During 95/96 the asset known as Sarita Shopping Centre is revalued with Land & Building for Rs.1,16,40,000/- and during 95/96 same amount is considered as assets of the firm. The revaluation reserve is credited to old partners Capital A/c. in ratio of Profit Sharing during that year”.

5. The facts as stated by the assessee are that it had taken two plots of land from Sarita Co-operative Housing Society Ltd. on lease for a period of 99 years without any premium consideration except annual lease rent of Rs.8,000/- payable to the lessor-Society as per lease deed executed on July 18, 1980. On construction of the first floor, the assessee was to pay a sum of Rs.16,000/- to the lessor. The assessee was assigned the right to transfer, assign or sub-lease the land alongwith constructions thereon. It kept the land and the shopping centres and godowns built thereon as non-business asset outside the balance sheet, and had shown the rental income from the said source as income from House Property.

6. In the enclosures to Form No.3CD, in the notes to the accounts, it had been mentioned that the firm was having shopping centre at Sarita Society at Bhavnagar, the cost of which was not recorded in the earlier year. During the financial year 1995-96 the asset known as Sarita Shopping Centre was revalued with land and building at Rs.1,16,40,000/- and during the financial year 1995-96 such amount was considered as asset of the firm. The revaluation reserve was created on the basis of a certificate of a Chartered Engineer who had certified the fair market value of the property at Rs.1,16,40,000/- and was credited to all the partners' capital account in ratio of profit sharing during the year. The assessee had acquired land in assessment year 1995-96 for Rs.12,00,000/- which came to

be revalued at Rs.61,00,000/-. In assessment year 1996-97, the assessee appropriated the capital account of the partners in the same ratio as mentioned in the partnership deed. In the enclosures to Form No.3CD, in the notes to the accounts, it had been mentioned that land has been revalued during the year and reserves created are credited to partners' capital account. Thus, the resultant value of both the properties, viz. the existing one in the balance sheet and the other one brought for the first time to Rs.49,00,000/- and Rs.1,16,40,000/- respectively, was brought into the stock of the business and corresponding credit of the extra value of Rs.1,65,40,000/- was given to the respective capital accounts in the profit sharing ratio of the partners.

7. The assessee executed an agreement called deed of partnership on 18th October, 1995 between seventeen partners who represented both the partnership firm and the intended formation of joint stock Company in the name of M/s. Kalathia Engineering & Construction Ltd. incorporated on February 16, 1996 with a view to convert the firm into a company. The company was incorporated with the same objects to deal in land, building, construction, etc. There was a further stipulation as sale consideration of the business of the firm transferred to the company by allotment of paid up share capital of Rs.2,00,00,000/- (Rupees two crores) with reference to 20,00,000 shares of Rs.10/- each.

8. The assessee after revaluing the asset at Rs.1,16,40,000/- credited the partners' capital account in the ratio of their share. The firm got converted into a limited company by the name of M/s. Kalathia Engineering &

Construction Ltd. and the shares to the extent of revaluation had been allotted to the partners in the firm or the Directors of the Limited Company. All the assets and liabilities of the firm upon its registration as a company under Chapter IX of the Companies Act, 1956 came to be taken over by M/s. Kalathia Engineering & Construction Ltd. For the land which was acquired in assessment year 1995-96 at the value of Rs.12,00,000/- which had been revalued at Rs.61,00,000/- in assessment year 1996-97, shares to the extent of revaluation came to be allotted to the partners as was done in the case of Sarita Shopping Centre.

9. The assessee was asked as to why the capital gain upon such transfer of the assets should not be brought to tax. The assessee replied that under Chapter IX of the Companies Act, the firm has been registered as M/s. Kalathia Engineering & Construction Ltd. and all the assets and liabilities have been owned by the company, hence there is no capital gain. Secondly, since the assets have been revalued in the hands of the firm and partners' capital have been appropriated accordingly, it cannot be said to be a transfer as the asset had remained in the firm. The assessee also made an application under section 144A of the Act before the Additional Commissioner of Income-tax on this issue claiming that capital gain does not arise as there is no transfer. The Additional Commissioner of Income-tax directed the Assessing Officer to consider the issue after looking into the submissions of the assessee. The assessee submitted that there was no transfer of property inasmuch as immovable property cannot be transferred without registration, and in this case there is no registration of such transfer; that there is no transfer as on

conversion of the firm to a company the property vests in the same persons in proportion of their interest. Thus, capital gain is not attracted in respect of the said transaction. Alternatively, without prejudice to the above, it was stated that if capital gain is to be levied, the valuation of Sarita Shopping Centre as on 1st April, 1981 should be considered. The value of Sarita Shopping Centre as on 1st April, 1981 was Rs.46,00,000/- and after giving effect of indexation the value comes to Rs.1,29,26,000/- which is more than the revaluation and hence no capital gain is to be levied.

10. The Assessing Officer observed that Sarita Shopping Centre was introduced for the first time in the books of accounts at the value of Rs.1,16,40,000/- which was nothing but the income of the assessee in the form of an asset which the assessee had earned in assessment year 1996-97. The Assessing Officer treated the same as receipt because all of a sudden the assessee had brought an asset. The Assessing Officer was further of the view that this income is also chargeable under section 28(iv) of the Act. The Assessing Officer held that since this benefit had arisen for the first time or such assets had been brought for the first time, its value is taxable and accordingly considered Rs.1,16,40,000/- as the income of the assessee and added the same to its total income. Alternatively, the Assessing Officer observed that in this transaction the assessee has transferred an asset where the cost of acquisition is nil for a consideration of Rs.1,16,40,000/- for Sarita Shopping Centre and for the land which had acquisition value of Rs.12,00,000/- for a consideration of Rs.65,00,000/-. The consideration received from Kalathia Engg. & Const. Co. Ltd. is in the form of shares of

the company in the ratio of share holding in the company which is the same as the profit sharing ratio in the firm. He, accordingly, worked out the capital gain as follows:

A) Sarita Shopping Centre

Sale consideration	Rs. 1,16,40,000/-
Less: Cost of acquisition	Rs. NIL
Capital Gain	Rs. 1,16,40,000/-

The Assessing Officer treated the same as short term capital gain as the asset had been brought for the first time in its books of account and added it to the income of the assessee.

B) Land

Sale consideration	Rs.61,00,000/-
Less: Cost of acquisition	Rs.12,00,000/-
Capital Gain	Rs.49,00,000/-

This was also treated as short term capital gain as the asset had been transferred within three years of acquisition and was added to the income of the assessee.

11. The assessee carried the matter in appeal before the Commissioner (Appeals). Before the Commissioner (Appeals), it was contended on behalf of the assessee that the need for revaluation of the assets of the firm represented by Sarita Shopping Centre arose because the assessee firm was to be converted into a joint stock company and wanted to enter the capital market by way of public issue for which the promoters were required to acquire capital of Rs.3,00,00,000/ (Rupees three crores). It was also contended that the revaluation of the above assets was also necessary for

obtaining banking facilities required for collection amount thereof. It was emphasised that bringing into the books of accounts, the value of a capital asset did not amount to accrual of income within the meaning assigned to the term 'income' under the Act. The provisions of section 28(iv) were not applicable as neither the act of bringing an asset into the books or revaluation thereof would amount to benefit or perquisite because the asset was already owned by the assessee, though not reflected in its books. The fact that the asset had been brought into its books did not amount to obtaining any benefit by the assessee. It was further contended that no capital gains had occurred when it had converted the firm into a joint stock company as in view of the provisions of Chapter IV of the Companies Act, the act of declaring a firm as a company did not amount to transfer. It was contended that if the property is transferred from an individual to himself, then no profit or gain accrues to such person. In support of such contention, reliance was placed upon the decision of the Supreme Court in **Sir Kikabhai Premchand v. CIT**, (1983) 24 ITR 506. Alternatively, it was submitted that if the transaction is held to be a transfer, it should be allowed deduction of the indexed cost of acquisition of the asset, namely, Sarita Shopping Centre. Various other contentions as detailed in the order passed by the Commissioner (Appeals) were raised. The written submissions were forwarded to the Assessing Officer for his comments thereon. The Assessing Officer in his remarks inter alia submitted that within a period of fifteen years from the date of acquisition of lease hold rights vide lease deed dated 18th July, 1980, a benefit or perquisite had accrued to the assessee which arose from its business. He also stated that the transfer

of assets from the assessee firm to the company was a transfer in accordance with section 2(17)(vi) which was liable to capital gains tax under section 45(4) of the Act. He, therefore, observed that the provisions for charging capital gains were applicable to the said transactions as the assessee firm and the company were two separate entities.

12. The Commissioner (Appeals), after considering the material on record, found that the assessee had acquired the asset of lease hold interest in the two plots on which shops and godowns were subsequently built on 18th July, 1980. It was only on 16th February, 1996 on which date the assessee firm was succeeded to a company known as M/s Kalathia Engineering & Construction Limited that the asset was transferred from the firm to the company for an amount of Rs.1,16,40,000/- The making of entries on 31st July, 1995 was not relevant to the date on which the said asset was acquired owned by the assessee firm. According to the Commissioner (Appeals), the law is settled that a transfer of assets by a partnership firm to the company comprising only of share holders who were earlier partners of the firm involves liability under section 45 of the Act. This position remained in force till assessment year 1998-99 when the law came to be amended with effect from 1st April, 1999 to provide that where a firm is succeeded by a company in the business carried on by it as a result of which the firm sells or otherwise transfers any capital asset to the company, the provisions of section 45 would not apply to such a transaction subject to certain conditions. Therefore, the aforesaid amendment is not applicable to such transfers made in the accounting period relevant to assessment year 1996-97. The capital gains arising on the transfer of a capital asset are

to be computed in accordance with the provisions of section 48 read with section 55 of the Act. The Commissioner (Appeals) noted that the assessee had contended that as per the provisions of Chapter IX of the Companies Act, the act of declaring a firm as a company does not amount to transfer and observed that the taxation of capital gains is governed by the provisions of the Income Tax Act. In view of the provisions of section 2(47) read with section 45 of the Act, any profits or gains arising from the transfer of a capital asset are chargeable to income tax under the head capital gains. Under the provisions of the Income Tax Act, a firm and a company are two separate persons. He, accordingly, held that a transfer of assets by a partnership firm to a company comprising only of share holders who were earlier partners of the firm attracts liability under section 45 of the Act [without reference to any particular sub-section] and directed the Assessing Officer to compute the capital gains as per the provisions of section 48 (18) read with section 55 of the Act. Insofar as the transfer of the second asset comprised of land valued at Rs.61,00,000/-, the Commissioner (Appeals) held that the Assessing Officer had rightly treated the capital gains arising from the said transaction as short term capital gains.

13. The assessee carried the matter in further appeal before the Tribunal, which allowed the appeal by holding thus:

"17. We have duly considered the rival contentions and the material on record. In view of the decision in the case of Texspin Eng. (supra) [decision of the Tribunal in Texspin Engineering & Manufacturing Works, 70 TTJ 789], this ground need not detain us too long. Firstly, it is not clear from the order of the revenue authorities as to under which sub-section of sec. 45, the amounts have been treated as

capital gains. The authorities below have taxed it as capital gains on the ground that there was transfer of assets from the firm to the company. Therefore, it can be assumed that this must have been treated as a transfer u/s.45(1) of the Act. But, as held by the Tribunal in the case of Texspin (supra), capital gains can be brought to assessment only, if the full value of the consideration is received by or accrues to the transferor. The consideration in the instant case is stated to be allotment of shares though the shares were issued by the company not to the firm but to its partners. Even if we consider that the shares somehow represented the consideration, the firm would not be liable to tax.

18. *If it is assumed to be transfer u/s.45(4) of the Act, then also it is difficult to fit in the facts of the present case to the provisions of sec. 45(4). One of the essential requirements to attract sec. 45(4) is that there must be distribution of capital assets belonging to the firm. Moreover, the sub-section implies distribution of capital assets "in specie". In the instant case, no such distribution has taken place. Therefore, viewed from any angle, it is difficult to accept the contention of the revenue that capital gains accrued to the assessee on its conversion into a joint stock company under Chapter IX of the Companies Act.*

19. *We need not deal with the issue whether the amounts are taxable either as casual income or u/s. 28(iv) of the Act, since finally AO treated it as capital gains only and the CIT(A) also had held it as such. Accordingly, the additions of Rs.1,16,40,000/- and Rs.49.00 lacs are deleted."*

14. Mr. M. R. Bhatt, Senior Advocate, learned counsel for the appellant assailed the impugned order by submitting that the assessee was a partnership firm and a separate legal entity and once it had transferred its assets to a different legal entity, viz. a private limited company, the transfer of assets took place and thereby capital gains tax became payable. The attention of the court was invited to section 2(47) of the Act which defines transfer and more particularly clauses (ii), (iv) and (vi) thereof, which provide that transfer in relation to a

capital asset, includes,- (ii) the extinguishment of any rights therein, or (iv) in case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment; or (vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immoveable property. It was submitted that upon conversion of the firm to a company, there is a transfer of assets as envisaged under the above provisions and hence, the transaction is exigible to capital gains tax.

14.1 Reference was made to sub-section (2) of section 45 of the Act which provides that notwithstanding anything contained in sub-section (1), the profits or gains arising from the transfer by way of conversion by the owner of a capital asset into, or its treatment by him as stock-in-trade of a business carried on by him shall be chargeable to income tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him and, for the purposes of section 48, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset. It was submitted that in the present case Sarita Shopping Centre has been revalued and brought to the books of the firm and hence section 45(2) of the Act can be clearly invoked upon the sale and at least the revaluation cost minus cost of acquisition will have to be brought to tax. Thus, the capital asset has been converted into

stock in trade and thereafter transferred to the company and hence, in view of section 45(2) read with section 2(47)(iv), that amount was exigible to capital gains tax. Also land which was acquired in the assessment year 1995-96 at the value of Rs.12,00,000/- has been revalued at Rs.61,00,000/- in assessment year 1996-97 and shares to the extent of revaluation have been allotted to the partners of the firm in proportion to the shares held by them as has been done in the case of Sarita Shopping Centre. Thus, the value of land has been enhanced by Rs.49,00,000/- and hence capital gain would arise under sub-section (4) of section 45 of the Act because of transfer of this asset to the company .

14.2 It was pointed out that section 47(xiii) of the Act which provides that a transaction involving any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm is not regarded as a transfer was brought on the statute book with effect from 1st April, 1999 and would therefore, not be applicable in the present case. It was submitted that since the assets of the firm have been transferred as a going concern, in view of the provisions of section 45(4) read with section 45(1) of the Act, the transaction would be exigible to capital gains tax more particularly since section 47(xiii) has been made applicable with effect from 1999 and prior thereto, such transactions were not exempted.

14.3 Reference was made to the decision of the Kerala High Court in **Kuttukaran Machine Tools v. Commissioner of Income-tax**, (2003) 264 ITR 305, wherein the court held

that as the business as a going concern was the capital asset which was the subject of the transfer and not the individual assets, the gain, if any, on the transfer of the business as a whole had to be computed and brought to tax.

14.4 Reliance was placed upon the decision of the Supreme Court in **Commissioner of Income-tax v. Artex Manufacturing Co.**, (1997) 227 ITR 260, wherein the assessee, a partnership firm, and a private limited company which was formed to take over the business of the assessee as a running concern, entered into an agreement whereunder the assessee agreed to sell to the company the business hitherto carried on by the assessee as a whole going concern. The assessee filed a revised return of income showing nil income with a note that since the partnership firm was converted into a private limited company as a going concern, there was no income chargeable to tax either under section 41(2) or under section 45 of the Act. The Income Tax Officer placed reliance upon the decision of the Supreme Court in **Commissioner of Income-tax v. B.M. Kharwar**, (1969) 72 ITR 603 and held that tax was payable under section 41(2) on the surplus amount, that is, the difference in the written down value of the plant, machinery and dead stock as per the assessee's books and the value of the same as revalued by Hargovandas Girdharlal. The Appellate Commissioner, on appeal, held that the surplus was assessable under the head "Capital Gains" and not "Business". The Tribunal in the appeals filed by the assessee as well as the revenue, rejected the contention of the assessee that the principle of mutuality was applicable and consequently the surplus was not liable to tax; and on the question as to if the surplus was found to be taxable, whether

it should be taxed under section 41(2) or under the head of “Capital Gains” held that the surplus was taxable under section 41(2) of the Act. At the instance of the assessee, the Tribunal inter alia referred the following questions for the opinion of the High Court:

1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the principle of mutuality will not apply and, therefore, the assessee was liable to be taxed?
2. Whether, on the facts and in the circumstances of the case, section 41(2) was applicable?
3. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the surplus was not capital gains, but was business income?

The High Court answered the first question in favour of the revenue and the second and third questions in favour of the assessee. The revenue carried the matter in appeal before the Supreme Court. Since the first question was answered in favour of the revenue, the appeal was confined to the other questions. The Supreme Court held that the income was chargeable to tax under section 41(2) of the Act. It, however, observed that since the liability under section 41(2) of the Act is limited to the amount of surplus to the extent of the difference between the written down value and the actual cost, if the amount of surplus exceeds the difference between the written down value and the actual cost, then the surplus amount to the extent of such excess will have to be treated as capital gain for the purpose of taxation.

14.5 It was submitted that the Tribunal has ignored the glaring fact that the transfer of business as a going concern by the firm to the company was for a consideration in the form of allotment of shares to its partners. Therefore, the same would fall within the purview of section 45(4) of the Act.

14.6 It was argued that the Tribunal has not considered the aspect that the non-business assets were brought into the books of account for the first time upon revaluation of the same and thereafter, the assets were transferred to the company. Therefore, such conversion of non-business assets into business assets in the form of stock-in-trade and the subsequent transfer is exigible to tax under section 45(2) of the Act.

14.7 It was, accordingly, urged that the impugned order passed by the Tribunal being erroneous and contrary to the settled legal position deserves to be set aside to the extent the same has been challenged in this appeal and the appeal deserves to be allowed

15. Opposing the appeal, Ms. Niyati Shah, learned advocate for the respondent assessee, supported the impugned order and submitted that the same is just, legal and proper and does not warrant interference by this court. It was submitted that for the purpose of applying section 45, there has to be a transfer within the meaning of the Act. Strong reliance was placed upon the decision of the Bombay High Court in **Commissioner of Income-tax v. Texspin Engg. & Mfg Works**, (2003)263 ITR 345 (Bom), wherein the court held that the expression “transfer of a capital asset” in section

45(1) is required to be read with section 2(47)(ii) which states that transfer in relation to a capital asset shall include extinguishment of any rights therein. The court observed that in the case before it, it was concerned with a Partnership Firm being treated as a Company under the statutory provisions of Part IX of the Companies Act. In such cases, the Company succeeds the Firm. Generally, in the case of a transfer of capital asset, two important ingredients are: existence of a party and a counter party and, secondly, incoming consideration qua the transferor. The court was of the view that when a Firm is treated as a Company, the said two conditions are not attracted. There is no conveyance of the property executable in favour of the Limited Company. It is no doubt true that all the properties of the Firm vest in the Limited Company on the Firm being treated as a Company under Part IX of the Companies Act, but that vesting is not consequent or incidental to a transfer. It is a statutory vesting of the properties in the Company as the Firm is treated as a Limited Company. On vesting of all the properties statutorily in the Company, the cloak given to the Firm is replaced by the different cloak and the same Firm is now treated as a Company, after a given date. The court was accordingly of the view that there was no transfer of a capital asset as contemplated under section 45(1) of the Act.

15.1 Ms. Shah accordingly, urged that when a partnership firm is converted to a company and the assets and liabilities are taken over, it is not a transfer of a capital asset within the meaning of such expression as envisaged under section 2(47) of the Act.

15.2 Reliance was placed upon the decision of the Punjab & Haryana High Court in the case of **Commissioner of Income-tax v. Rita Mechanical Works**, (2012) 344 ITR 544 (P&H), wherein the court in a similar set of facts followed the decision of the Bombay High Court in **Texspin Engg. & Mfg. Works** (supra) and held that no capital gain under section 45(4) of the Act would be attracted. The court also observed that the decision of the Gujarat High Court in **Artex Manufacturing Co.'s** case was a matter where the entire assets and liabilities of the partnership were not transferred to the limited company. The business of the firm as a whole was not transferred for a lump sum to the limited company but only the machinery used in manufacturing of the business of the firm was transferred to the newly formed limited company and the consideration was received by the partners of the firm in the shape of shares of the company and the shares were allotted to the partners on the same basis as their shares in the profits of the partnership firm. It was on those facts that the provisions of capital gains were held to be exigible. Reliance was also placed upon the decision of the Andhra Pradesh High Court in **Commissioner of Income-tax v. United Fish Nets**, MANU/AP/1546/2014, wherein the court followed the decision of the Bombay High Court in **Texspin Engineering and Manufacturing** (supra).

15.3 Reliance was also placed upon the decision of the Supreme Court in the case of **PNB Finance Ltd. v. Commissioner of Income-tax-I New Delhi**, (2008) 307 ITR 75, wherein the court held thus:

“18. In Artex Mfg. Co.¹ this Court found that a valuer

was appointed, that valuer submitted his valuation report in which itemised valuation was carried out and on that basis the consideration was fixed at Rs 11,50,400. Therefore, the sale consideration had been arrived at after taking into account the value of plant, machinery and dead stock as computed by the valuer and, consequently, it was held that the surplus arising on the sale was taxable under Section 41(2) of the Act and not as capital gains. In the circumstances, the judgment of this Court in *Artex Mfg. Co.*¹ is not applicable to the present case.

19. Further, this Court in *CIT v. Electric Control Gear Mfg. Co.*³ has held that whether the business of the assessee stood transferred as a going concern for slump sale price, in the absence of evidence on record as to how the slump price stood arrived at, Section 41(2) had no application. It is interesting to note that the judgment in *Electric Control Gear Mfg. Co.*³ is given by the same Bench which decided the case of *Artex Mfg. Co.*¹ In fact, both the judgments are reported one after other in 227 ITR at pp. 260 and 278 respectively.

20. In the present case, as can be seen from the impugned judgment of the Delhi High Court, the judgment of this Court in *Electric Control Gear Mfg. Co.*³ is missed out. That judgment has not been considered by the High Court. As stated above, this Court has clarified its judgment in *Artex Mfg. Co.*¹ in its judgment in *Electric Control Gear Mfg. Co.*³ Therefore, Section 41(2) has no application to the facts of the present case.

21. As regards applicability of Section 45 is concerned, three tests are required to be applied. In this case, Section 45 applies. There is no dispute on that point. The first test is that the charging section and the computation provisions are inextricably linked. The charging section and the computation provisions together constituted an integrated code. Therefore, where the computation provisions cannot apply, it is evident that such a case was not intended to fall within the charging section, which, in the present case, is Section 45. That section contemplates that any surplus accruing on transfer of capital assets is chargeable to tax in the previous year in which transfer took place. In this case, transfer took place on 18-7-1969.

22. The second test which needs to be applied is the test of allocation/attribution. This test is spelt out in the judgment of this Court in *Mugneeram Bangur & Co.*² This test applies to a slump transaction. The object behind this test is to find out whether the slump price was capable of being attributable to individual assets, which is also known as item wise earmarking.

23. The third test is that there is a conceptual difference between an undertaking and its components. Plant, machinery and dead stock are individual items of an undertaking. Business undertaking can consist of not only tangible items but also intangible items like, goodwill, manpower, tenancy rights and value of banking licence. However, the cost of such items (intangibles) is not determinable.

24. In *CIT v. B.C. Srinivasa Setty*⁴ this Court held that Section 45 charges the profits or gains arising from the transfer of a capital asset to income tax. In other words, it charges surplus which arises on the transfer of a capital asset in terms of appreciation of capital value of that asset. In the said judgment, this Court held that the "asset" must be one which falls within the contemplation of Section 45. It is further held that the charging section and the computation provisions together constitute an integrated code and when in a case the computation provisions cannot apply, such a case would not fall within Section 45. In the present case, the banking undertaking, inter alia, included intangible assets like goodwill, tenancy rights, manpower and value of banking licence. On facts, we find that item wise earmarking was not possible. On facts, we find that the compensation (sale consideration) of Rs 10.20 crore was not allocable item wise as was the case in *Artex Mfg. Co.*¹

25. For the aforesaid reasons, we hold that on the facts and circumstances of this case, which concerns Assessment Year 1970-1971, it was not possible to compute capital gains and, therefore, the said amount of Rs 10.20 crore was not taxable under Section 45 of the 1961 Act. Accordingly, the impugned judgment is set aside."

15.4 It was accordingly submitted that without prejudice to the contention that there is no transfer, even if there is a

transfer, it is a slump sale and section 45 would not apply to the present case as the entire undertaking has been transferred as a going concern.

15.5 Reliance was placed upon the decision of this court in ***Commissioner of Income-tax v. Garden Silk Weaving Factory***, (2005) 279 ITR 136 (Gujarat), for the proposition that where what was sold by the assessee-firm to the limited company was its running business as a going concern together with all the assets and liabilities and the provision of section 41(2) of the Act cannot be invoked. Reliance was also placed upon the decision of this court in ***Assistant Commissioner of Income Tax v. Patel Specific Family Trust***, (2011) 330 ITR 397 (Guj), for the proposition that in case of sale of the entire business, including all assets and liabilities, as a going concern, it was not possible to bifurcate the consideration received on account of the transfer.

15.6 As regards the contention raised by the learned counsel for the appellant that the present case would fall within the ambit of section 45(2) of the Act as the capital assets had been converted into stock in trade, it was submitted that it was never the case of the revenue that the liability arises under section 45(2) of the Act and it is for the first time only before this court after twenty years that contention of section 45(2) is taken.

15.7 Reliance was also placed upon an unreported decision dated 3rd December, 2014 of this court rendered in the case of ***Dy. C.I.T. v. Well Pack Packaging***, in Tax Appeal No.368 of 2001, wherein the court agreed with the view

adopted by the Bombay High Court in *Commissioner of Income-tax v. Texspin Engineering and Manufacturing Works* (supra) as well as the decision of the Punjab and Haryana High Court in the case of *Commissioner of Income-tax v. Rita Mechanical Works* (supra) and answered the questions in favour of the assessee. It was submitted that the controversy, therefore, stands concluded in favour of the assessee by above decision of this court and if the court is not inclined to take a similar view, the matter should be required to be referred to a larger bench.

15.8 It was, accordingly, urged that the impugned order passed by the Tribunal being just, legal and proper, there is no warrant for interference by this court.

16. In rejoinder, Mr. M.R. Bhatt, learned counsel for the appellant submitted that the Bombay High Court in ***Commissioner of Income-tax v. Texspin Engineering and Manufacturing Works*** (supra) has held that firm and company are one and the same meaning thereby that the principle of mutuality is attracted. It was submitted that in the present case, the assessee contends that the transaction is not at all exigible to tax on the ground of mutuality, whereas in ***Artex Mfg. Co. v. Commissioner of Income-tax***, (1981) 131 ITR 559, this High Court has held that the principle of mutuality would not apply in that case. Under the circumstances, the principle of mutuality would not be applicable to the facts of the present case.

16.1 It was submitted that the decision of the Bombay High Court in ***Commissioner of Income-tax v. Texspin***

Engineering and Manufacturing Works (supra) may not be accepted as this court's observation regarding mutuality has not been taken into consideration. It was contended that to the extent of mutuality the decision of the Gujarat High Court in **Artex Mfg. Co. v. Commissioner of Income-tax** stands confirmed by the Supreme Court, that firm and company are distinct entities. It was argued that the Bombay High Court in **Commissioner of Income-tax v. Texspin Engineering and Manufacturing Works** does not consider words "or otherwise" appearing in section 45(4). To that extent the view taken by the Bombay High Court is not correct.

17. It is in the backdrop of the aforesaid facts and contentions that the controversy involved in the present case has to be examined. In the facts of the present case, capital gains tax is sought to be levied in respect of immovable property being land and building. Insofar as the building being Sarita Shopping Centre is concerned the same was for the first time brought into the books of account after revaluation only in the year under consideration. Evidently, therefore, no depreciation had been claimed in respect thereof. Under the circumstances, the question of invoking section 41(2) of the Act would not arise in the present case. Strong reliance has been placed by the learned counsel for the appellant on the decision of the Supreme Court in the case of **Commissioner of Income-tax v. Artex Manufacturing Co.** (supra) for the purpose of contending that the transaction would be exigible to capital gains tax. In the facts of that case, it may be noted that the High Court had held that the principle of mutuality would not be attracted and since such finding was in favour of the revenue the same was not subject matter of challenge

before the Supreme Court. Under the circumstances, the Supreme Court had no occasion to examine such issue. The main question before the Supreme Court was as to whether the transfer of a going concern is liable to tax under section 45 of the Act or under section 41(2). The court on facts found that the said case was not one in which it cannot be said that the price attributed to the items transferred was not indicated and hence, section 41(2) of the Act cannot be applied. The court, however, held that the liability under section 41(2) is limited to the amount of surplus to the extent of the difference between the written down value and the actual cost. If the amount of surplus exceeds the difference between the written down value and the actual cost, then the surplus amount to that extent of such excess will have to be treated as capital gain for the purpose of taxation. It may be noted that in the facts of the said case, while all the assets and liabilities of the firm came to be transferred to the company as a going concern, it was not a case where the firm came to be converted into a company under Chapter IX of the Companies Act.

18. As can be seen from the orders passed by the Assessing Officer and the Commissioner (Appeals), the Assessing Officer has held that there was short term capital gain in respect of Sarita Shopping Centre as well as the land, whereas the Commissioner (Appeals) has held that there was long term capital gain in respect of Sarita Shopping Centre and short term capital gain in respect of the land. The question that, therefore, requires to be addressed is as to whether the provisions of section 45 of the Act are attracted in the facts of the present case. For the purpose of attracting sub-section (1) of section 45 of the Act profit or gain should have arisen from

the transfer of a capital asset. Sub-section (2) of section 45 of the Act provides that the profits or gains arising from the transfer by way of conversion by the owner of a capital asset into, or its treatment by him as stock-in-trade of a business carried on by him shall be chargeable to income tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him and, for the purposes of section 48, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset. Insofar as invocation of sub-section (2) of section 45 of the Act is concerned, while the Assessing Officer has briefly referred to the said provision in paragraph 5.7 of his order, no factual foundation has been laid down in that regard to establish that the said properties had been brought into the books as stock-in-trade. On the contrary the learned counsel for the assessee has maintained that the said properties were always treated as capital assets and were never converted into stock in trade. Under the circumstances, in the absence of any factual foundation having been laid in that regard, the question of invoking sub-section (2) to section 45 of the Act would not arise. Sub-section (4) of section 45 of the Act provides that the profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or a cooperative society) or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place and, for the purposes of section 48, the fair market value of the asset on the date of such transfer shall be deemed to be the full value

of the consideration received or accruing as a result of the transfer. The inquiry that is now required to be made is as to whether the ingredients of section (1) or (4) of section 45 of the Act are satisfied in the present case.

19. At this juncture, it would be apposite to refer to the decision of the Bombay High Court in **Commissioner of Income-tax v. Texspin Engineering and Manufacturing Works** (supra) wherein while dealing with a similar set of facts, the court has held thus:

"Findings [A] On [Section 45\(4\)](#)

5. In this matter, we are concerned with assessment year 1996-97. [Section 45\(1\)](#) is a charging section as far as capital gains is concerned. Under [Section 45\(4\)](#), profits arising from transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm is chargeable to tax as income of the firm in a previous year in which the transfer takes place and for the purposes of [Section 48](#), the fair market value of the asset on the date of such transfer is deemed to be the full value of the consideration received or accruing as a result of the transfer. [Section 48](#) deals with mode of computation. It, inter alia, lays down that the income chargeable under the head "Capital gains" shall be computed by deducting from the full value of the consideration, the expenditure incurred in connection with the transfer and the cost of acquisition of the asset. Therefore, under [Section 45\(4\)](#), two conditions are required to be satisfied viz. transfer by way of distribution of capital assets and secondly, such transfer should be on dissolution of the firm or otherwise. Once these two conditions are satisfied then, in that event, for the purposes of computation of capital gains under [Section 48](#), the market value on the date of the transfer shall be deemed to be the full value of consideration received or accruing as a result of the transfer.

Now, according to the Assessing Officer, in this case, on vesting of the properties of the firm in the Limited Company, there was a transfer by way of distribution of

capital assets. Further, according to the Assessing Officer, on vesting of the properties of the firm in the company, there was a resultant dissolution of the firm. Therefore, according to the Assessing Officer, both the conditions under [Section 45\(4\)](#) stood satisfied and, therefore, he was entitled to take the fair market value of the asset on the date of the transfer to be the full value of the consideration received as a result of the transfer. It is for this reason that the Assessing Officer has computed the capital gains under [Section 48](#) by referring to the comparative figures of the book value and the market value. As stated above, in this connection, the Assessing Officer has computed capital gains arising to the assessee-firm at Rs. 9 lakhs on the basis of the difference between the market value and the written down value. The Assessing Officer has taken the written down value as on 1st April, 1995 and he has taken the market value as on 8th November, 1995 (alleged date of transfer) and on that basis, he has computed the capital gains. However, as stated, computation under [Section 45\(4\)](#) read with [Section 48](#) would arise only if the aforesaid two conditions are satisfied to attract [Section 45\(4\)](#).

In this case, the erstwhile firm has been treated as a Limited Company by virtue of [Section 575](#) of the Companies Act. It is not in dispute that in this case, the erstwhile firm became a Limited Company under Part IX of the Companies Act. Now, [Section 45\(4\)](#) clearly stipulates that there should be transfer by way of distribution of capital assets. Under Part IX of the Companies Act, when a Partnership Firm is treated as a Limited Company, the properties of the erstwhile firm vests in the Limited Company. The question is whether such vesting stands covered by the expression "transfer by way of distribution" in [Section 45\(4\)](#) of the Act. There is a difference between vesting of the property, in this case, in the Limited Company and distribution of the property. On vesting in the Limited Company under Part IX of the Companies Act, the properties vest in the company as they exist. On the other hand, distribution on dissolution presupposes division, realisation, encashment of assets and appropriation of the realised amount as per the priority like payment of taxes to the Government, BMC etc., payment to unsecured creditors etc. This difference is very important. This difference is amply brought out conceptually in the judgment of the Supreme Court in the case of [Malabar Fisheries Co. v. CIT](#)[1979] 120 ITR 49 2 Taxman 409. In the present case, therefore, we are of the view that [Section](#)

[45\(4\)](#) is not attracted as the very first condition of transfer by way of distribution of capital assets is not satisfied. In the circumstances, the latter part of [Section 45\(4\)](#), which refers to computation of capital gains under [Section 48](#) by treating fair market value of the asset on the date of transfer, does not arise.

[B] On [Section 45\(1\)](#)

6. As stated above, in this case we are concerned with the assessment year 1996-97. Therefore, in this case, we are not concerned with clause (xiii) inserted by Finance (No. 2) Act, 1998 in [Section 47](#) under which it is provided that where a Firm is succeeded by a company in the business carried on by it as a result of sale or otherwise, of any capital assets, then such transaction shall not be regarded as transfer. This clause was inserted with effect from 1st April, 1999. Therefore, we are not concerned with that amendment. However, it provides a clue to the legislative intent. In our opinion, this clause has been introduced with effect from 1st April, 1999 in order to encourage more and more Firms becoming Limited Companies. It also indicates the difference between transfer and transmission. Basically, when a Firm is treated as a company under Part IX, it is a case similar to transmission. This is amply made clear by clause (xiii) to [Section 47](#), which states that where a Firm is succeeded by a company in the business, the transaction shall not be treated as a transfer. Now, this amendment has been made in [Section 47](#) in view of the controversy arising on [Section 45\(1\)](#) read with [Section 2\(47\)\(ii\)](#).

As stated above, [Section 45\(1\)](#) is a charging section. [Section 45](#), read with the computation Section viz. 48 etc., form one composite scheme. This point is very important. [Section 45\(1\)](#) provides that where any profit, arising from transfer of a capital asset is effected in the previous year then such profit shall be chargeable to income-tax under the head "Capital gains". The expression "transfer of a capital asset" in [Section 45\(1\)](#) is required to be read with [Section 2\(47\)\(ii\)](#) which states that transfer in relation to a capital asset shall include extinguishment of any rights therein. The moot point which arose on interpretation of [Section 45\(1\)](#) in numerous matters was that on extinguishment of the rights in the capital assets, there was a transfer and in certain cases of reconstitution of firms and introduction of new partners, there was a resultant

extinguishment of the rights in the capital assets proportionately. In order to get over this controversy, and keeping in mind the object of encouraging Firms being treated as Companies, the controversy is resolved by the Legislature by introducing clause (xiii) in [Section 47](#) with effect from 1st April, 1999.

Now, in the present case, it is argued on behalf of the department before the Tribunal, for the first time, that in this case, on vesting of the properties of the erstwhile Firm in the Limited Company, there was a transfer of capital assets and, therefore, it was chargeable to income-tax under the head "Capital gains" as, on such vesting, there was extinguishment of all right, title and interest in the capital assets qua the Firm. We do not find any merit in this argument. In the present case, we are concerned with a Partnership Firm being treated as a company under the statutory provisions of Part IX of the Companies Act. In such cases, the Company succeeds the Firm. Generally, in the case of a transfer of a capital asset, two important ingredients are: existence of a party and a counterparty and, secondly, incoming consideration qua the transferor. In our view, when a Firm is treated as a Company, the said two conditions are not attracted. There is no conveyance of the property executable in favour of the Limited Company. It is no doubt true that all properties of the Firm vests in the Limited Company on the Firm being treated as a Company under Part IX of the Companies Act, but that vesting is not consequent or incidental to a transfer. It is a statutory vesting of properties in the Company as the Firm is treated as a Limited Company. On vesting of all the properties statutorily in the Company, the cloak given to the Firm is replaced by a different cloak and the same Firm is now treated as a Company, after a given date. In the circumstances, in our view, there is no transfer of a capital asset as contemplated by [Section 45\(1\)](#) of the Act. Even assuming for the sake of argument that there is a transfer of a capital asset under [Section 45\(1\)](#) because of the definition of the word "transfer" in [Section 2\(47\)\(iii\)](#), even then we are of the view that liability to pay capital gains would not arise because [Section 45\(1\)](#) is required to be read with [Section 48](#), which provides for mode of computation. These two sections are required to be read together as the charging section and the computation section constitute one package. Now, under [Section 48](#) it is laid down, inter alia, that the income chargeable under the head "Capital

gains" shall be computed by deducting from the full value of the consideration received or accrued as a result of the transfer, the cost of acquisition of the asset and the expenditure incurred in connection with the transfer. [Section 45\(4\)](#) is mutually exclusive to [Section 45\(1\)](#). [Section 45\(4\)](#) categorically states that where there is a transfer by way of distribution of capital assets and where such transfer is due to dissolution or otherwise of the firm, the Assessing Officer was entitled to treat the market value of the asset on the date of the transfer as full value of the consideration received. This latter part of [Section 45\(4\)](#) is not there in [Section 45\(1\)](#). Therefore, one has to read the expression "full value of the consideration received/accruing" under [Section 48](#) de hors [Section 45\(4\)](#) and if one reads [Section 48](#) with [Section 45\(1\)](#) de hors [Section 45\(4\)](#) then the expression "full value of consideration" in [Section 48](#) cannot be the market value of the capital asset on the date of transfer. In such a case, we have to read the said expression in the light of the two judgments of the Supreme Court in the cases of *George Henderson & Co. Ltd.* (supra) and *Gillanders Arbuthnot & Co.* (supra) in which it has been held that the expression "full value of the consideration" does not mean the market value of the asset transferred, but it shall mean the price bargained for by the parties to the transaction. It has been further held that consideration for the transfer of a capital asset is what the transferor receives in lieu of the assets he parts with viz. money or money's worth and, therefore, the very asset transferred or parted with cannot be the consideration for the transfer and, therefore, the expression "full value of the consideration" cannot be construed as having a reference to the market value of the asset transferred and that the said expression only means the full value of the things received by the transferor in exchange of the capital asset transferred by him. In the circumstances, even if we were to proceed on the basis that vesting in the company under Part IX constituted transfer under [Section 45\(1\)](#), still the assessee ought to succeed because the Firm can be assessed only if the full value of the consideration is received by the Firm or if it accrues to the Firm. In the present case, the Company had allotted shares to the Partners of the erstwhile Firm, but that was in proportion to the capital of the Partners in the erstwhile Firm. That allotment of shares had no correlation with the vesting of the properties in the Limited Company under Part IX of the Act. Lastly, [Section 45\(1\)](#) and [Section 45\(4\)](#) are mutually

exclusive. Under [Section 45\(4\)](#) in cases of transfer by way of distribution and where such transfer is as a result of dissolution, the department is certainly entitled to take the full market value of the asset as full value of consideration provided there is transfer by distribution of assets. In this case, we have held that there is no such transfer by way of distribution and, therefore, [Section 45\(4\)](#) is not applicable. This deeming provision, regarding full value of consideration, is not there in [Section 45\(1\)](#) read with [Section 48](#). If one reads [Section 45\(1\)](#) with [Section 48](#), it is clear that the former is a charging section and if that section is applicable, the computation has to be done under [Section 48](#), which only refers to deductions from full value of consideration received or accruing. [Section 48](#) does not empower the Assessing Officer to take market value as full value of consideration as in the case of [Section 45](#). In the circumstances, even if we were to hold that vesting amounts to transfer, the computation is not possible because it has been laid down in the above judgment of the Supreme Court that full consideration cannot be construed to mean market value of the asset transferred. The Legislature, in its wisdom, has amended only [Section 45\(4\)](#) by which the market value of the asset on the date of the transfer is deemed to be the full value of consideration. However, such amendment is not there in [Section 45\(1\)](#).

In the circumstances, neither [Section 45\(1\)](#) nor [Section 45\(4\)](#) stand attracted.” [Emphasis supplied]

19.1 This court is in complete agreement with the view adopted by the Bombay High Court in the above decision and is further of the view that the said decision applies on all fours to the present case. In the opinion of this court the distinction sought to be drawn by the learned counsel for the appellant that in view of the decision of this court in **Artex Mfg. Co. v. Commissioner of Income-tax** (supra) the principle of mutuality would not be applicable to the facts of the present case would be of no avail to the appellant as on facts, the provisions of section 45(1) and section 45(4) of the Act would not be attracted in the present case. On behalf of the appellant

it has been contended that the above decision does not take into consideration the words “or otherwise” appearing in section 45(4) of the Act and therefore to that extent the view taken by the Bombay High Court in the said decision is not correct. In the opinion of this court, the said contention is required to be stated only to be rejected for the reason that under sub-section (4) of section 45 of the Act, the profits and gains arising from transfer of a capital asset by way of distribution of capital assets on dissolution of firm or otherwise are chargeable to tax. Therefore, the primary requirement for invoking the said sub-section is that there has to be distribution of capital assets, which factor is totally missing in the present case as there is no distribution of capital assets either by way of dissolution of the firm or otherwise.

20. Besides, as rightly submitted by the learned counsel for the assessee, this court in **Dy. C.I.T v. Well Pack Packaging** (supra) has agreed with the view adopted by the Bombay High Court in the above decision, and none of the submissions advanced by the learned counsel for the appellant could persuade this bench to take a different view.

21. In the opinion of this court, the view adopted by the Tribunal appears to be in consonance with the view adopted by the Bombay High Court in the above decision. Under the circumstances, there is no warrant for interference by this court. The learned counsel for the respondent-assessee has referred to various decisions as noted hereinabove; however, having regard to the view adopted by this court, it is not necessary to discuss the same in detail.

22. In the light of the above discussion, the question is answered in the affirmative, that is, in favour of the assessee and against the revenue. The appeal, therefore, fails and is, accordingly, dismissed.

(Harsha Devani, J.)

(A.G. Uraizee, J.)

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