

A

COMMISSIONER OF INCOME TAX

v.

MUGNEERAM BANGUR & CO.

March 31, 1965

[K. SUBBA RAO, J. C. SHAH AND S. M. SIKRI, JJ.]

B

Income-tax Act (11 of 1922)—Sale of going concern—Slump price—When part attributable to stock-in-trade.

C

The business of the assessee firm, carrying on land development business was sold as a going concern to a company promoted by the assessee's partners. The purchase price included sums for the value of land, goodwill, etc. The amount shown as the value of the goodwill was sought to be assessed to income-tax on the grounds (i) that the assessee's business was purely one of buying and selling land and (ii) the amount was profit attributable to the sale of land which was the stock-in-trade of the assessee. In appeal to this Court.

D

HELD: On the facts of this case it could not be said that the assessee was carrying on the business of purely buying and selling land. They were engaged in buying land, developing it and then selling it. The sale was the sale of the whole concern and no part of the slump price was attributable to the cost of the land. If that was so, no part of it was taxable. [617H-618A, E]

E

Commissioner of Income-tax, Kerala v. West Coast Chemical and Industries Ltd. 46 I.T.R. 135 and *Doughty v. Commissioner of Taxes* (1927) A.C. 327, applied.

F

In the case of a concern carrying on the business of buying land, developing it and the selling it, it is easy to distinguish a realisation sale from an ordinary sale, and it is very difficult to attribute part of the slump price to the cost of land sold in the realisation sale. The mere fact that in the schedule the price of land was stated did not lead to the conclusion that part of the slump price was necessarily attributable to the land sold. There was no evidence that any attempt was made to evaluate the land on the date of sale. As the assessee was transferring the concern to a company, constituted by the assessee themselves, no effort would ordinarily have been made to evaluate the land as on the date of sale. [618B-D]

G

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 310 of 1964.

Appeal by special leave from the judgment and order dated December 13, 1961 of the Calcutta High Court in Income-tax Reference No. 74 of 1956.

N. D. Karkhanis, Gopal Singh and R. N. Sachthey, for the appellant.

A. V. Viswanatha Sastri, S. Murthy and B. P. Maheshwari, for the respondent.

H

The Judgment of the Court was delivered by

Sikri, J. This is an appeal by special leave directed against the judgment of the High Court at Calcutta in a reference under

s. 66 of the Income Tax Act. The four questions referred to the High Court by the Income Tax Appellate Tribunal are: A

- “(1) Whether on the facts and circumstances of this case the Income-tax Officer, Central Circle XIV, Calcutta, was competent to file the appeal before the Tribunal against the order of the Appellate Assistant Commissioner of Income Tax, Range-A, Calcutta? B
- (2) Whether on the facts and circumstances of this case the sum of Rs. 2,50,000 represented the surplus on the sale of lands which was the stock in trade of the assessee company or was the value of goodwill alleged to have been transferred? C
- (3) Whether on the facts and circumstances of this case by the sale of the whole business concern it could be held that there was taxable profit in the sum of Rs. 2,50,000? D
- (4) Whether on the facts and circumstances of this case and in view of the findings of the Tribunal that the entire share capital of the vendee company (excepting seven ordinary shares) was taken over by the vendor firm in lieu of the sale price of the business as a whole, there was any profit in the amount of Rs. 2,50,000 the same being taxable under the Indian Income Tax Act? E

The relevant facts and circumstances are these. The respondent, M/s Mugneeram Bangur & Co. (Land Department) Calcutta (hereinafter referred to as the vendors) were a firm carrying on the business of land development in Calcutta. By an agreement dated July 7, 1948, the partners of the firm agreed to sell all the business of the said firm to the Amalgamated Development Limited, hereinafter called the vendee, which company was promoted by the partners of the firm. The relevant paragraphs of the said agreement are as follows : F

“And Whereas the Vendors have agreed to sell and the company has agreed to purchase all the said business on the basis hereinafter set out. G

Now it is hereby agreed and declared between the parties as follows:—

1. The Vendors do hereby agree to sell and the company doth hereby agree to purchase All That the said business with effect from the eighth day of July One thousand nine hundred and forty-eight. Together with the goodwill of the said business And all stock in trade, fixtures, tools, implements, furniture, fittings and all other articles and things belonging to the said business or in any way used in the same including the benefit and advantages of all contracts. H

- A** 2. The purchase price shall be Rupees thirtyfour lakhs nintynine thousand and three hundred paid and satisfied by the Company allotting to the Vendors or their nominees seventeen thousand five hundred Redeemable Preference shares of Rupees one hundred each and seventeen thousand four hundred and
- B** ninetythree Ordinary shares of Rupees one hundred each in the capital of the Company which will be accepted by the Vendors in full satisfaction of the said purchase price.
- C** 3. The Company shall undertake and discharge all debts and liabilities of the Vendors including development expenses such as opening out roads, laying out drains and sanitary arrangements providing electricity in the areas and providing a School in Tollygunge for education of Children for which the Vendors have given an undertaking to the Tollygunge Municipality and also the liability of the Vendors in respect of the deposits made with them by various intending purchasers of lands but excluding the liabilities of the Vendors for Income-tax, Super-tax or any other tax or duty on income or revenue in respect of the profits of the business".
- D**
- E**

The sum of Rs. 34,99,300 was arrived at in the Schedule thus:

		(In rupees)	
F	1. Land	12,68,628	7 7
	2. Goodwill	2,50,000	0 0
	3. Motor Car & Lorries	25,866	8 6
	4. Furniture, Fixture etc.	5,244	5 6
G	5. Mortgage secured	71,62,367	6 0
	6. Deposits for purchase of land	53,500	0 0
	7. Advance paid to pleaders solicitors, contractors' staff and other outstandings	1,83,622	3 6
	8. Cash in Bank	71,800	1 8
		<hr/>	
		36,21,029	0 9
		Less liabilities ..	1,21,729 0 9
		<hr/>	
		34,99,300	0 0

The consideration of Rs. 34,99,300 was paid by allotment of 17,500 Redeemable Preference shares of Rs. 100 each and 17,493 Ordinary shares of Rs. 100 each, the allotment being to the vendors-partners or their nominees. Thus, the vendors received shares of the face value of Rs. 34,99,300 for the assets transferred to the company.

The Income Tax Officer held that the sum of Rs. 2,50,000 was actually charged by the vendors as a lump sum amount of profits on sale of valuable stock in trade and not goodwill as alleged. The Appellate Assistant Commissioner, on appeal, held that the said sum of Rs. 2,50,000 was the value of the goodwill. He further held that since the transfer was a transfer of business as a going concern, the profit was the capital gain and therefore not liable to tax. Relying on *Doughty v. Commissioner of Taxes*,⁽¹⁾ he held that as "the transfer is a transfer of all assets of the firm to a company the transfer is a capital sales".

The Income Tax Officer filed an appeal before the Appellate Tribunal. The Appellate Tribunal held that although the sale was the sale of a business as a going concern, the value of the stock could be traced, and, therefore, the profits arising out of the sale was taxable income. Regarding the goodwill, the Tribunal observed:

"We do not think that there was much value of the goodwill of the business that was transferred. Mugneeram Bangur & Co. was a firm constituting of several partners and Mugneeram Bangur & Co. Land Department was a separate firm consisting of the same partners with, however, different shares in the firm Mugneeram Bangur & Co. were also carrying on business in lands and buildings along with its activities in other businesses. Our attention was drawn by the Department Representative to the fact that in the case of transfer of lands and buildings of the assessee firm the conveyances were as a rule executed in the name of Mugneeram Bangur & Co. The assessee's learned Counsel did not object to this fact. We are therefore accepting it as correct. If so, there was nothing in the name of Mugneeram Bangur & Co. Land Department. The conversion of the said firm into a Company in an entirely different name would also indicate that not much of importance was attached to the name of Mugneeram Bangur & Co. Land Department. In the circumstances, in our opinion, the price paid by the purchase Company was not on the consideration of the goodwill of the

(1) [1927] A.C. 327.

A vendors but upon taking over the entire going concern and paying the consideration not in money but by allotment of shares. In such circumstances, the surplus was out of the sale of the business as a whole, including the stock in trade of the assessee firm. Since the other assets transferred had definite value which would not increase in value by the process of transfer, the only value that could increase was the value of the stock in hand, that being the land in the present case. In our opinion, therefore, the amount of Rs. 2,50,000 was really the excess value of the lands sold along with the other assets”.

B

C But the Tribunal dismissed the appeal on the ground that although the vendors were a different entity from the vendee, the first being a partnership and the second being a limited company, the transaction was mere adjustment of the business position of the partners. It further observed that the Income Tax Department was not entitled to take mere book-keeping entries as the evidence of any profit in the matter.

D The High Court first answered question No. 4, thus:

E “There was no profit in the transaction by which the entire stock in trade and the business of the firm were transferred to the limited company. Again the fact that two outsiders were brought in as directors with seven shares allotted to them out of 39,300 shares makes no difference. In *Sir Homi Mehta’s* case 400 shares out of 6,000 shares were allotted to *Sir Homi Mehta’s* sons. Nor again can I see any difference in principle between the case of conversion of business into a private limited company and one in which it is converted into a public limited company if in the latter company outsiders are not allotted any sizeable proportion of the shares issued”.

F

G The High Court felt that this answer was enough to dispose of the matter, but as questions 2 and 3 had been referred, they answered them. Regarding question No. 2, the High Court held that “as the assets of the firm transferred to the company have been itemised and as there can be no question of variation of the figures given in items 3 to 8 in the agreement for sale, it must be held that Rs. 2,50,000 shown as the value of the goodwill must be represented by surplus on the sale of lands which was the stock-in-trade of the assessee company”. Regarding question No. 3, the High Court held that even if the value of the stock in trade taken over by the assessee was greater than the figure shown therefor in the agreement for sale in view of the answer to question 4, there was no profit which could be taxed.

We may mention that it is not necessary to deal with question No. 1 because it was given up before the High Court. Mr. Karkhanis, learned counsel for the appellant, urges that the *Doughty's case*⁽¹⁾ was wrongly decided in one respect and that the vendors and the vendee being different entities, it is not permissible to tear the corporate veil to see whether the partners of the vendors were the same persons as the shareholders of the vendee. He says that if the veil is not torn, then there was a sale by the vendors to the vendee and profits arose out of the sale. Learned counsel for the respondent, Mr. Viswanatha Sastri, says that if the third question is answered in his favour, it would not be necessary to deal with the other questions. As we are inclined to answer the third question in the favour of the vendors, it is not necessary to deal with the other questions and the arguments addressed in respect of them.

The Appellate Tribunal held in this case that the sale was a sale of business as a going concern. This is also apparent from clause 1 of the agreement set out above. If this is so *Doughty's case*⁽¹⁾ applies. The facts in *Doughty's case* may be conveniently taken from the headnote in that case. "In 1920, two partners carrying on business in New Zealand as general merchants and drapers sold the partnership business to a limited company in which they became the only shareholders. The sale was of the entire assets, including goodwill, the consideration being fully paid shares, and an agreement by the company to discharge all the liabilities. The nominal value of the shares being more than the sum to the credit of the capital account of the partnership, in its last balance sheet, a new balance sheet was prepared showing a larger value for the stock in trade. The Commissioner of Taxes treated the increase in value so shown as a profit on the sale of the stock in trade, and assessed the appellant upon it for income tax under the Land and Income Tax Act, 1916, of New Zealand, which imposes the tax on all profits or gains derived from any business"

The Privy Council decided the case in favour of the appellant on two grounds, the first being that "if the transaction is to be treated as a sale, there was no separate sale of the stock, and no valuation of the stock as an item forming part of the aggregate which was sold". In connection with this ground, Lord Phillimore observed that "income-tax being a tax upon income, it is well established that the sale of a whole concern which can be shown to be a sale at a profit as compared with the price given for the business, or at which it stands in the books does not give rise to a profit taxable to income-tax". He further observed that "where, however, the business consists, as in the present case, entirely in buying and selling, it is more difficult to distinguish between an ordinary and a realization sale, the

(1) [1927] A.C. 327.

A object in either case being to dispose of goods at a higher price than that given for them, and thus to make a profit out of the business. The fact that large blocks of stock are sold does not render the profit obtained anything different in kind from the profit obtained by a series of gradual and smaller sales. This might even be the case if the whole stock was sold out in one sale. Even in the case of a realization sale, if there were an item which could be traced as representing the stock sold, the profit obtained by that sale, though made in conjunction with a sale of the whole concern, might conceivably be treated as taxable income". Lord Phillimore concluded with the following observations:

C "If a business be one of purely buying and selling, like the present, a profit made by the sale of the whole of the stock, if it stood by itself, might well be assessable to income tax; but their view of the facts (if it be open to them to consider the facts) is the same as that of Stout C.J.—that is, that this was a slump transaction".

D This Court, in *Commissioner of Income-tax, Kerala v. West Coast Chemicals and Industries Ltd.*⁽¹⁾ understood the *Doughty's case*⁽²⁾ thus:

E "This case shows that where a slump price is paid and no portion is attributable to the stock-in-trade, it may not be possible to hold that there is a profit other than what results from the appreciation of capital. The essence of the matter, however, is not that an extra amount has been gained by the selling out or the exchange but whether it can fairly be said that there was a trading from which alone profits can arise in business".

F It follows from the above that once it is accepted that there was a slump transaction in this case, i.e. that the business was sold as a going concern, the only question that remains is whether any portion of the slump price is attributable to the stock in trade.

G The learned counsel for the appellant relies on two grounds to support the contention that there is profit attributable to the sale of land which was stock-in-trade of the vendors. He says first that in the schedule to the agreement the value of land and the value of goodwill and other items is specified. He says that although the amount of Rs. 2,50,000 was shown as price of goodwill, it was really excess value of the land sold along with other assets. Secondly, he says, relying on the passage already cited above from *Doughty's case*⁽²⁾ that the vendors' business was a business of purely buying and selling land. In our opinion, on the facts of this case it cannot be said that the vendors were carrying on the business of purely buying and selling land. In

(1) 46 I.T.R. 135.

(2) [1927] A.C. 327.

this case the vendors were engaged in buying land, developing it and then selling it. The agreement itself shows that the vendors had already incurred debts and liabilities for development expenses such as opening out roads, laying out drains and sanitary arrangements, providing electricity and providing for a school. **A**

It seems to us that in the case of a concern carrying on the business of buying land, developing it and then selling it, it is easy to distinguish a realisation sale from an ordinary sale, and it is very difficult to attribute part of the slump price to the cost of land sold in the realisation sale. The mere fact that in the schedule the price of land is stated does not lead to the conclusion that part of the slump price is necessarily attributable to the land sold. **B**
There is no evidence that any attempt was made to evaluate the land on the date of sale. As the vendors were transferring the concern to a company, constituted by the vendors themselves, no effort would ordinarily have been made to evaluate the land as on the date of sale. What was put in the schedule was the cost price, as it stood in the books of the vendors. Even if the sum of Rs. 2,50,000 attributed to goodwill is added to the cost of land, it is nobody's case that this represented the market value of the land. **C**
D

In our view the sale was the sale of the whole concern and no part of the slump price is attributable to the cost of land. If this is so, it is clear from the decision of this Court in *Commissioner of Income-tax, Kerala v. West Coast Chemicals and Industries Ltd.*⁽¹⁾ and *Doughty's case*⁽²⁾ that no part of the slump price is taxable. We, therefore, answer question No. 3 in the negative. As stated before, in view of this answer, it is not necessary to answer questions Nos. 2 and 4. **E**

The appeal is accordingly dismissed with costs.

Appeal dismissed.

(1) 46 I.T.R. 135.

(2) [1927] A.C. 327.