A COMMISSIONER OF INCOME TAX, GUJARAT

v.

M/S. ELECTRIC CONTROL GEAR MFG. CO.

JULY 8, 1997

B [S.C. AGRAWAL AND G.B. PATTANAIK, JJ.]

Income Tax Act, 1961—Sections 41, 114—Partnership concern—Transfer of business as a going concern to a limited company—Liability to tax u/s. 41(2) and liability to capital gains—Nothing to indicate price attributable to C *assets like machinery, plant or building out of total consideration amount—Whether provisions of Section 41(2) applicable—Held, No—Status of assessee was that of an association of persons.*

The assessee, a partnership concern entered into an agreement whereby it transferred the entire assets of business together with liabilities D **as a going concern to a limited company for a consideration of Rs. 8 lakhs. The Income Tax Officer held that depreciation allowed to the assessee firm in respect of the assets transferred by the firm to the company as chargeable to tax u/s. 41(2) of the Income Tax Act, 1961 and included capital gains after excluding the sum of Rs. 5,000 as basic exemption, in** E **the computation of the total income of the assessee under the head 'Capital Gains'. In appeal, the Appellate Assistant Commissioner held that the impugned profits were taxable under the provisions of sec. 41(2) of the Act but the the capital gains could not be taxed in the hands of registered firm u/s. 114 of the Act. The Income Tax Appellate Tribunal remitted the matter to the Income Tax Officer for recomputation of the aggregate amount** F **chargeable as profits u/s. 41(2) and as capital gains while holding that the correct status of the should be 'registered firm' and not 'association of person'.**

In reference, the High Court held that the Tribunal was right in G **holding that the provisions of Sec. 41(2) were applicable; that the status of the assessee was a registered firm and that of an association of persons and that the assessee was entitled to any relief on the basis of the two circulars relied on by it. The present appeal had been filed by the Revenue against the judgment of the High Court.**

H **Allowing the appeal partly, this Court**

HELD : In the present case there is nothing to indicate the price attributable to the assets like the machinery, plant or building out of the consideration amount of Rs. 8 Lakhs. Merely because a sum of Rs. 3,32,863 had been allowed as depreciation to the assessee firm, it could not be said that was the excess amount between the price and the written down value. The High Court, therefore, rightly held that the provisions of Section 41(2) were not applicable. On the question of status of the assessee, the High Court rightly held that the Tribunal was not right in holding that the status of the assessee was a registered firm and not that of an association of persons. However, on the facts and in the circumstances the High Court was not right in holding that the assessee was entitled to relief on the basis of the two circulars relied on by it. [574-A; 573-D; 572-H; 573-A]

C.I.T. **v.** *M/s. Artex Manufacturing Co.,* **[1997] Supp. 1 S.C.R. 608, relied on.**

Artex Manufacturing Co. **v. C.I.T., (1981) 131 ITR 559 (Guj.), distinguished.**

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 101 of 1982.

From the Judgment and Order dated 29.8.80 of the Gujarat High Court in I.T.R. No. 281 of 1975.

B. Krishna Prasad for the Appellant.

P.H. Parekh, Sunita Sharma and R. Deepamala for the Respondent.

The Judgment of the Court was delivered by

S.C. AGRAWAL, J. : This appeal by certificate is directed against the judgment of the Gujarat High Court dated August 29, 1980. The matter relates to the assessment year 1967-68. The assessee is a partnership concern consisting of 13 partners. On March 31, 1966 it entered into an agreement whereby it transferred the entire assets of business together with liabilities as a going concern to a limited company, styled M/s. Electric Control Gear Pvt. Ltd. for a consideration of Rs. 8 lakhs. The erstwhile partners of the assessee firm were allotted the shares of the same value in their profit sharing proportion. The Income Tax Officer held that depreciа-

A tion allowed to the assessee firm amounting to Rs. 3,32,863 in respect of the assets transferred by the firm to the said company was chargeable to tax under the provisions of Section 41(2) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act'). He also brought to tax capital gains of Rs. 8 lakhs, being purchase consideration received by the assessee and after excluding the sum of Rs. 5,000 as basic exemption, included the sum B of Rs. 7,95,000 in the computation of the total income of the assessee under the head 'Capital Gains'. The Appellate Assistant Commissioner held that the impugned profits were taxable under the provisions of Section 41(2) of the Act. As regards capital gains, the Appellate Assistant Commissioner, however, held that the capital gains could not be taxed in the hands of the C registered firm under the provisions of section 114 of the Act. Appeals were filed by the assessee as well as the Revenue against the said judgment of the Appellate Assistant Commissioner. The assessee challenged the liability to tax under Section 41(2) of the Act as well as the liability to capital gains while the Revenue challenged the decision of the Appellate Assistant Commissioner about recomputation of profits under Section D 41(2) as well as non-levy of capital gains in the hands of the registered firm under the provisions of Section 114 of the Act. The Income Tax Appellate Tribunal remitted the matter to the Income Tax Officer for recomputation of the aggregate amount chargeable as profits under Section 41(2) and as capital gains. The Tribunal held that the correct status of the assessee should be 'registered firm' and not 'association of persons'. The Tribunal E 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 was not applicable?

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2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the provisions of Section 41(2) were applicable?

3. Whether, on the facts and in the circumstances of the case, G the Tribunal was right in holding that the assessee has earned capital gains, which was liable to tax under the provisions of Section 45 of the Income Tax Act, 1961?

4. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the status of the H assessee was a registered firm and not that of an association

of persons? A

5. Whether, on the facts and in the circumstances of the case, the Tribunal rightly rejected the claim of the assessee that surplus realised by it on sale to the limited company was not chargeable to tax, being realisation sale? B

6. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that Section 34(2) will apply and, therefore, the assessee is not entitled to depreciation?

7. Whether, on the facts and in the circumstances of the case, C the Tribunal was right in holding that the registered firm can be liable to capital gains under S. 114 of the Income Tax Act, 1961?

8. Whether, the Tribunal was right in holding that the assessee was not entitled to any relief on the basis of the two circulars D relied on by it?

Question Nos. 1, 3 and 5 were answered by the High Court in affirmative, i.e., in favour of the Revenue and against the assessee, question Nos. 2, 4, and 8 were answered in the negative, i.e., against the Revenue and in favour of the assessee, question No. 6 was not pressed by the learned E counsel for the assessee and question No. 7 was not answered since it did not survive in view of answer to question No. 4. The present appeal relates to question Nos. 2, 4 and 5 which have been answered against the Revenue.

The High Court has placed reliance on its judgment in *Artex* F *Manufacturing Co.* v. *Commissioner of Income Tax, Gujarat-II,* (1981) 131 ITR 559. The said judgment of the High Court has been considered by us in our judgment pronounced today in C.A. No. 2276(NT) of 1981, *The Commissioner of Income Tax* v. *M/s. Artex Manufacturing Co.*. In that case, we have held that Section 41(2) was applicable since price attributable to G the Plant, machinery and dead-stock which were transferred had been disclosed by the assessee during the course of assessment proceedings before the Income Tax Officer and that the said price was as per the value assessed by the valuers at the time of execution of the agreement. In the present case there is nothing to indicate the price attributable to the assets like the machinery, plant or building out of the consideration amount of H

A Rs. 8 lakhs. Merely because a sum of Rs. 3,32,863 had been allowed as depreciation to the assessee firm, it could not be said that was the excess amount between the price and the written down value. Question No. 2 was, therefore, rightly answered against the Revenue by the High Court. On question No. 4 the High Court has taken the same view as was taken by it while answering question No. 4 in *M/s. Artex Manufacturing Co.* (supra). B The said view has been affirmed by us in our judgment in that case. Question No. 8 is similar to question No. 5 in *M/s. Artex Manufacturing Co.* (supra). The view of the High Court with regard to that question has been reversed by us in our judgment in the case and for the same reasons question No. 8 must be answered in the affirmative, i.e., in favour of the C Revenue and against the assessee.

In result the appeal is partly allowed to the extent that the answer given by the High Court to question No. 8 is set aside and the said question is answered in the affirmative, i.e., in favour of the Revenue and against the assessee. The answers given by the High Court to question Nos. 2 and D 4 are affirmed. No order as to costs.

R.A. Appeal partly allowed.