

# **Messrs. Associated Clothiers Ltd vs Commissioner Of Income-Tax, Calcutta on 23 September, 1966**

**Equivalent citations: 1967 AIR 788, 1967 SCR (1) 512, AIR 1967 SUPREME COURT 788**

**Author: J.C. Shah**

**Bench: J.C. Shah, V. Ramaswami, Vishishtha Bhargava**

PETITIONER:  
MESSRS. ASSOCIATED CLOTHIERS LTD.

Vs.

RESPONDENT:  
COMMISSIONER OF INCOME-TAX, CALCUTTA

DATE OF JUDGMENT:  
23/09/1966

BENCH:  
SHAH, J.C.  
BENCH:  
SHAH, J.C.  
RAMASWAMI, V.  
BHARGAVA, VISHISHTHA

CITATION:  
1967 AIR 788                      1967 SCR (1) 512

ACT:  
Indian Income-tax Act, 1922 (11 of 1922), s. 10(2)(vii)-Sale of assets by one company to another-Circumstances in, which sale can be treated as "in substance to self"-Applicability of s. 10(2)(vii) to such transaction.

HEADNOTE:  
The appellant a private limited company, was originally registered as /s. Phelps & Company Ltd." but on March 21, 1952 by an order under S. 11(4) of the Indian Companies Act, 1913, its name was changed to "Messrs Associated Clothiers Ltd." On the same day a company styled "Messrs. Phelps & Co. Ltd." was incorporated. By a written agreement, also of the same date, the appellant company agreed to transfer its assets to Messrs Phelps & Co. Ltd. Consideration for the

transfer consisted, apart from cash, of allotment of certain shares of Messrs Phelps & Co. Ltd. to the appellant and the taking over of the latter's liabilities by the former. Among the assets transferred under the agreement was a building described in the second schedule to the agreement. The original cost of this building was Rs. 97,252/- and its written value was Rs. 57,011/-, but in the balance sheet for the account year ending March 31, 1953 as well as in the aforesaid agreement its value was shown as Rs. 2, 4,573/-. In Income-tax proceedings relating to the account year 1952-53 the Income-tax Officer brought to tax under s. 10(2)(vii) of the Indian Income-tax Act, 1922, the difference between the original cost and the written down value of the building on the date of transfer. Before the Income-tax Appellate Tribunal it was contended by the appellant that the sale of the assets of the appellant company was 'in substance to self' and therefore S. 10(2)(vii) was inapplicable. The Tribunal decided, in favour of the company but the High Court held against it. The company thereupon came to this Court in appeal by certificate.

HELD: The sale was by one company to another, it was not a case in which persons carrying on business had floated a private limited company and had attempted to readjust their business positions. The sale was for a stated consideration which had not been shown to be notional and since the consideration was in excess of the original cost of the building the difference between the original cost and the written down value was profit within the meaning of s. 10(2)(vii) second proviso. [517 G-H; 519 F]

Sir Homi Mehta's Executors' case, 28 I.T.R. 928 and Rogers & Co. v. Commissioner of Income-tax, Bombay City II 34 I.T.R. 336, distinguished.

Chittoor Motor Transport Co. (P) Ltd. v. Income-tax Officer, Chittoor, 59 I.T.R. 238, relied on.

Bank of Chettinad Ltd. v. Commissioner of Income-tax, Madras, 8 I.T.R. 522., Maharajadhiraj Sir Kameshwar Singh v. Commissioner of Income-tax, Bihar and Orissa, 48 I.T.R. 483 and Doughty v. Commissioner of Taxes, [1927] A.C. 327, referred to.

#### JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 969 of 1965.

Appeal from the judgment and order dated February 5 1963 of the Calcutta High Court in Income-tax Reference No. 3 of 1958.

S. S. Shukla, for the appellant.

S. T. Desai, A. N. Kripal and R. N. Sachthey, for the respondent.

The Judgment of the Court was delivered by Shah, J. M/s. Phelps & Company Ltd. was registered as a private limited company on September 30, 1939 to carry on the business of "Clothiers and Tailors". On March 21, 1952 under an order made under s. 11(4) of the Indian Companies Act, 1913, the name of the Company was altered to Messrs Associated Clothiers Ltd. On the same day a company styled "Messrs. Phelps & Co. Ltd." was incorporated. By a written agreement also of the same date the appellant Company agreed to transfer its assets and liabilities to Messrs. Phelps & Co. Ltd. in consideration of allotment of shares of the value of Rs. 12,30,000/of Messrs. Phelps & Co. Ltd. and Rs' 23,291/10/5 payable in cash, and Messrs. Phelps & Co. Ltd. taking over liabilities of the appellant Company of the aggregate amount of Rs. 6,05,601/-/6. Under the terms of the agreement the appellant Company purported to transfer seven items of property described in the Schedules annexed to the deed : one of the properties so agreed to be transferred was described in the second scheduled building at Connaught Place, New Delhi, valued at Rs. 2,24,673/-. No deed of conveyance was executed in pursuance of the agreement. It is, however, common ground that on July 1, 1952, Messrs. Phelps & Co. Ltd. took over possession of the properties agreed to be sold.

The original cost of the building described in the second schedule was Rs. 97,258/- and the written down value of the building after deducting depreciation allowed from time to time in the records of the Income-tax Officer was Rs. 57,011/-. In the balance sheet of the appellant Company dated March 31, 1953 the building was valued at Rs. 2,24,673/- the price for which it was agreed to be sold. In proceedings for assessment for the account year 1952-53 the Income-tax Officer, Companies, District IV, Calcutta, brought to tax the difference between the original cost and the written down value of the building on the date of the transfer as deemed profit of the appellant Company under the second proviso to s. 10(2)(vii) of the Indian Income-tax Act, 1922. Before the Appellate Tribunal it was contended that the sale of assets to the appellant Company was "in substance to self" and on that account no profit had resulted to the Company and the amount sought to be brought to tax was not liable to be included in the Company's profit. The Tribunal relying upon the decision of the Bombay High Court in Commissioner of Income-tax, Bombay City v. Sir Homi Mehta's Executors(1) upheld that contention.

At the instance of the Commissioner of Income-tax, Calcutta the following question was referred to the High Court of Calcutta "Whether on the facts and in the circumstances of the case the Tribunal was right in holding that the sum of rupees forty thousand two hundred and forty seven could not be deemed to be profits of the assessee company under second proviso to, s. 10(2)(vii) of the Indian Income-tax Act ?"

The High Court answered the question in the negative. Against the order passed by the High Court, with certificate under s. 66A(2) of the Indian Income-tax Act, this appeal is preferred.

The High Court was of the view that the principle of the decisions in Sir Homi Mehta's Executor's case() and in Rogers & Co. v. Commissioner of Income-tax, Bombay City 11(2), did not apply to the facts of the present case, since at all material

times there were in existence two corporations which were distinct and the transfer by one corporation of its assets to another cannot be deemed to be a transfer to self; that the transaction by which the appellant Company transferred its assets to Messrs. Phelps & Co. Ltd. was a transaction of sale, and the doctrine of "lifting the veil of corporate personality" had application only to a limited class of cases, and the case of the appellants could not be brought within that class; and since the two companies "continued to exist side by side" for many years after the appellant Company had transferred its assets to Messrs Phelps & Co. Ltd., two different Companies which carried on business simultaneously could not be regarded as one entity. In this appeal with certificate, the appellant Company contends that the High Court gravely erred in recording its opinion on the question submitted, relying on evidence which was never placed before the Income-tax Officer or the Tribunal. Counsel urged that the observations made by the High Court that Messrs. Phelps & Co. Ltd. and the appellant Company "continued to exist side by side as two separate limited Companies" and carried on business simultaneously for, more than ten years is borne out by no evidence on the record. This criticism has force. The High Court in a reference under s. 66(1) or (2) is bound to proceed on the findings recorded by the Income-tax Appellate Tribunal: it has no power to admit on record additional evidence, as the High Court did, and to consider that additional evidence which was not placed before the Tribunal. We must therefore proceed on the view (1) 28 I.T.R. 928.

(2) 34 I.T.R. 336.

that there is no evidence before the Tribunal and no finding of the Tribunal that after transferring its assets the appellant Company carried on business.

Counsel for the Company also submitted that the Tribunal was in error in 'observing that the appellant Company had transferred all its assets and liabilities to the new Company. But in the statement of the case which is based upon the judgment of the Tribunal, there is a clear recital

-that all the assets and liabilities of the appellant Company were transferred to Messrs. Phelps & Co. Ltd. Counsel asked us to ignore that statement in view of the recital made in the preamble clause of the agreement dated March 29, " 1 952 in which it was recited that Messrs. Phelps & Co. were "desirous of acquiring a part of the undertaking and property of the Vendor Company." But there is nothing in the recitals which indicates that any assets were retained by the appellant Company. The Tribunal in deciding the appeal before it observed "Associated Clothiers Ltd. were owners of a business having assets and liabilities. By sale to Phelps & Co. Ltd. they got the entire ownership by way of 'shares and the same assets and liabilities remained in the hands of Phelps & Co. Ltd."

This Court must accept the statement made by the Tribunal in the statement of the case, especially when no objection was raised thereto before the Tribunal or before the High Court on behalf of the appellant Company at any time. On the question whether in determining liability of an assessee to pay income-tax it is open to the court to ignore the corporate personality of a Company and to fix

upon the ownership of the business as decisive, there has been some difference of opinion. In Sir Homi Mehta's Executors' case() the assessee and his sons had formed a private limited company and transferred to that company shares in several joint stock companies which the assessee held jointly with his sons at the market value of the shares at that time. The departmental authorities levied income-tax on the difference between the market price and the cost price of the shares. The High Court of Bombay held that the so-called sale of the shares to the Company was not a business activity entered into with the object of earning profit; that it was not really a sale but a procedure adopted for readjustment of their position as holders of the shares; and that the assessee did not make any profit or gain in a commercial sense by transferring the shares to the Company and therefore the difference between the market price and cost price of the shares was not exigible to tax as profit of the business.

(1) 28 I.T.R. 928.

In Rogers & Co.'s case(1) the partners of a firm carrying on the business of manufacturing aerated waters formed themselves into a private limited company, the shares allotted to each of them in the company being in the same proportions as the shares they held in the firm. The assets of the firm were transferred to the company for a price exceeding the written down value, and the difference between the original cost of the assets and the written down value was brought to tax under s.10(2)(vii) of the Income-tax Act. The High Court held that the transfer of the assets of the firm to the Company was merely a readjustment made by the members to enable them to carry on their business as a Company rather than as a firm and no profit in a commercial sense was made thereby, and therefore the transfer of the assets of the firm to the Company was not a sale and the provisions of the second proviso to s.10 (2) (vii) did not apply.

Chagla, C.J., in delivering the judgment in Sir Homi Mehta's Executors' case(2) observed at p. 932;

"Whatever legal or technical form a transaction may take, the Court must try and determine what, the real transaction was and not the form which the transaction took."

Again .the learned Chief Justice in Rogers & Company's case(t) observed that in all transactions which come up for consideration in a taxing statute the Court has to look not at the legal form which the transaction has, but to the real nature of the transaction, Counsel for the Revenue contends that in ignoring the legal form and relying upon "the substance of the transaction" the High Court of Bombay has erred. He relies in support of his submission upon the following observations in the judgment of the Judicial Committee in Bank of Chettinad Ltd. v. Commissioner of Income-tax, Madras(3) at p. 526 :--

"The Commissioner of Income-tax in his reference stated that "in substance these loans represent money lent by the Pudukottai Bank to the Kanadukathan Bank but the transactions have been unnecessarily complicated by resorting to a series of entries which are as superfluous as they are confusing."

Their Lordships think it necessary once more to protest against the suggestion that in revenue cases "the substance of the matter" may be regarded as distinguished from the strict legal position."

But the decision of the Court in Sir Homi Mehta's Executors' case(2) was not rounded only upon the ground that the real transaction" was different from what it purported to be. The Court (1) 34 I.T.R. 336. (2) 28 I.T.R.

928. (3) 8 I.T.R. 522.

in the two cases opined that in determining whether a certain transaction resulted in profit, it must be found that the transaction resulted in real profit,-profit which from the commercial point of view meant a gain to the person who entered into the transaction, and that by transferring the assets with the intention merely to readjust the business relation of the owners of a business or assets no real profit was earned.

Counsel for the Revenue relied upon the decision of the Patna High Court in Maharajadhiraj Sir Kameshwar Singh v. Commissioner of Income-tax, Bihar & Orissa(1). It was held in that case that the doctrine that no man can make a profit out of himself is not applicable to transactions between a person and a limited company, even though all the shares in the company are owned by that person, because from "a legal point of view a company is an entity entirely distinct from its shareholders." The Court observed at p. 495 ".....it is not possible in the circumstances of this case, to ignore or disregard the mask of corporate entity or to analyse the economic realities behind the transaction of sale."

Therefore the assessee though he was the owner of all the shares in the company could not claim to be treated as if he were identical with the Company in order to promote his own benefit or advantage. But in Maharajadhiraj Sir Kameshwar Singh's case(') it seems to have been admitted that the price for which the buildings, machinery and plant were transferred to the Company was not a notional figure, and the price being in excess of the cost of buildings, machinery and plant, s. 10(2)(vii) proviso was attracted, and the difference between the written down value and original cost was held taxable.

It is unnecessary for the purpose of this case to express any final opinion on the question, whether in taxing cases it is open to the assessing authority to ignore the corporate personality of a company and to hold that the interest of the shareholders in the shares of a company and on the business of the Company is identical, and transfer by the owners of a business to a Company in 'which the shares are owned by the former owners of the business does not give rise to a sale in a commercial sense. The present is not a case in which persons carrying on business have floated a private limited company and have attempted to readjust their business position. Here is a case in which the assets of one company have been sold to another. The question to which attention must be directed is whether there was by the agreement, a transaction of sale in a commercial sense. (1) 48 I.T.R. 483.

In a recent judgment of this Court in Chittoor Motor Transport Co. (P) Ltd. v. Income-tax Officer, Chittoor,(1) it was held by this Court that where a private limited company transferred some of its

assets to a partnership consisting of three shareholders who held the entire issue of shares of the company for a consideration, but the whole business was not transferred, there was in truth a sale within the meaning of Sale of Goods Act and under s. 10(2)(vii) the rebate received by the private limited company would be liable to be forfeited. This Court declined to accept the argument that when the company transferred the vehicles belonging to it to the partnership, there was no commercial transaction. The Court observed at p. 242 :

"If we look at the resolution dated June 30, 1959, it is quite clear that, it is a sale for consideration of a number of buses by the limited company to the partnership. It would be a sale under the Sale of Goods Act and it would be a sale in any other proper meaning which might be given to the word 'sale'. We are not concerned whether any profit resulted to the assessee but what we are concerned with is whether the assessee had sold or transferred these buses to the partnership. To us the answer seems to be plain that whether the transaction resulted in profit to the company or not, the transaction comes within the purview of the latter part of section 10(2)(vii)."

Counsel for the Company also submitted that the transaction was merely a nominal transaction and the property in the shares renamed with the same Company in which it was vested. This contention was never raised before or decided by the Tribunal, and it does not arise out of the order of the Tribunal.

It was then urged that there was no profit to the Company since there was no evidence about the market value of the property transferred and in the absence of any evidence to show that the property was sold for a price exceeding the written down value, liability under s. 10(2)(vii) second proviso will not arise. But in the agreement the properties sold were allotted specific values and no attempt was made at any time before the Tribunal to prove that the values so allotted to the various properties were not true. Substantially the whole of the consideration paid by Messrs. Phelps & Co. Ltd. is in the form of shares to the appellant Company, but unless there is evidence that the market value of the shares was less than their face value, the claim made by the appellant Company must fail. The burden of proving that the consideration for sale of the property was less than what it purports to be under the agreement of sale lay upon the Company and since no attempt was made to prove that fact, the question cannot be raised for the first time in this Court.

(1) 59 I.T.R. 238.

It was also said that the transfer was a slump sale of the assets and there being no separate sale of the property described in the second schedule, the difference between the written down value and the cost price was not liable to be included as income in the process of assessment. Reliance in this behalf was placed upon the observations of the Judicial Committee of the Privy Council in *Doughty v. Commissioner of Taxes*(1). In that case two partners carrying on business as general merchants and drapers sold the entire assets and goodwill of the partnership business to a limited company in which they became the only shareholders. 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. The Judicial Committee held that the assessment was wrongly made since if the transaction was to be treated as a sale there was no separate sale of the stock, and no valuation of it as an item forming part of the aggregate sold. This Court has affirmed the principle in Doughty's case in a recent judgment : Commissioner of Income-tax v. Mugneeram Bangur & Company (2).

That principle has however no application here. In the present case it is true that the entire assets of the appellant Company were sold to Messrs. Phelps & Co. Ltd. There was no separate sale of different items, but the consideration of each item of property sold was expressly mentioned in the agreement of sale. The contention that the transaction of sale was a mere attempt to readjust the business position of the transferor was never raised before the Tribunal and does not arise out of the order of the Tribunal.

We decide this appeal on the narrow ground that the appellant Company sold the property in the second schedule for a stated consideration which was not shown to be notional, and since the consideration was in excess of the original cost of the building, the difference was profit within the meaning of s. 10(2)(vii) second proviso. The appeal therefore fails and is dismissed with costs.

G.C.

Appeal dismissed.

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

(2) 57 I.T.R. 299.

16Sup. C. I./66-5