The Commissioner Of Income-Tax, ... vs Gillanders Arbuthnot & Co.Vice Versa on 27 September, 1972

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Bench: K.S. Hegde, P. Jaganmohan Reddy, I.D. Dua, Hans Raj Khanna

PETITIONER:
THE COMMISSIONER OF INCOME-TAX, CALCUTTA

Vs.

RESPONDENT:
GILLANDERS ARBUTHNOT & CO.Vice Versa

DATE OF JUDGMENT27/09/1972

BENCH:
HEGDE, K.S.
BENCH:
HEGDE, K.S.
REDDY, P. JAGANMOHAN
DUA, I.D.
KHANNA, HANS RAJ

CITATION:
1973 AIR 989 1973 SCR (2) 437
1973 SCC (3) 845
CITATOR INFO :
RF 1991 SC1806 (9)

ACT:
Income-tax Act 1922, Ss. 12B & 34--Capital gains--Transaction whether a sale, a readjustment or an exchange--Income-tax authorities whether can go to substance of transaction apart from legal relationship created by transaction--Shares--Full value of--Where there is a sale price it must be treated as full value--Reopening of assessment--Validity of notice under s. 24(1) (a).

HEADNOTE:

The assessee, a registered firm carrying on mostly managing agency business, originally consisted of four partners. By partnership deed dated February 28, 1947, a limited company (whose only shareholders were the four partners of the assessee firm) was taken in as a fifth partner. The company was given a share of 99% in the newly constituted firm in lieu of a sum of Rs. 14,90,000 to be paid by it to the existing partners. Further, by an 'agreement of sale' dated February 28, 1947 the assessee firm transferred its share-holdings to the company for a sum of Rs. 75 lakhs. The above sums of Rs. 14,90,000 and Rs. 75 lakhs were satisfied by the company allotting its shares to the existing partners at face value. In respect of the assessment year 1947-48 the Income-tax Officer made originally an assessment without taking into account any capital gains. Later he issued a notice under s. 34 of the Income-tax Act, 1922, and made a fresh assessment holding that the assessee firm had made capital gains, inter alia, on the sale of its shareholding for Rs. 75 lakhs, because, the market value of the, shares allowed by the company to the assessee firm was much higher than Rs. 75 lakhs, the face value. The validity of the notice under s. 34 was upheld by the authorities as well as in reference by the High Court. The High Court held that the transaction in question was a 'sale' attracting the provisions of s. 12-B of the Act and that the capital gain was Rs. 27,4,772 on the basis that the sale price received by the assessee firm was Rs. 75 lakhs. In appeals filed by the Revenue as well as by the assessee firm the questions that fell for consideration were; (i) whether the notice under s. 34(1)(a) was validly issued in the circumstances of the case; (ii) whether the transaction in question was a `sale' as it purported to be under the 'agreement of sale' or a mere readjustment as claimed by the assessee firm, or an exchange as contended by the Revenue; (iii) whether the capital gains were to be computed on the basis of market value of the shares allotted to the assessee firm or on the basis of their value as shown in the 'agreement of sale' i.e. Rs. 75 lakhs.

HELD : (1) Though at the time of the original assessment, the partnership deed entered into by the five partners was before the Income-tax Officer, the sale deed executed by the partners of the assessee firm in favour of the 'Company' on February 28, 1947 had not been placed before him. There was no material before the income-tax Officer on the basis of which he could have concluded that the assessee firm had sold any shares and securities to the 'Company'; nor was there any material before the Income-tax Officer as to the value of those shares and securities as on

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January 1, 1939. Further no material was placed before him to show that those shares and securities had been sold to the 'Company' for a sum of Rs. 75 lakhs. The Tribunal and the-High Court rightly held that the assessee had failed to

disclose fully and truly all material facts for the purpose of ascertaining whether it bad made any capital gains or not.[445 D]

Calcutta Discount Co. Ltd. v. Income-tax Officer, Companies District-1, Calcutta and Anr., 41 I.T.R. 191, explained and applied.

Commissioner of Income-tax, West Bengal and Anr. v. Hemchandra Kar and Ors, 77 I.T.R. P. 1, Commissioner of Income-tax Gujarat v. Bhanji Lavji, 79 I.T.R. 583 and Commissioner of Income-tax Calcutta v. Burlon Dealers Ltd., 79 I.T.R. 609, referred to.

(ii) Section 12-B was incorporated into the Act with effect from April 1, 1947. That being so, at the time the sale transaction took place s. 12-B was not a part of the Act. Hence there was no basis for saying that the transfer was effected with the object of avoidance or reduction of the liability of the assessee. [447 D]

(iii) The taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by a device the legal relation, it is open to the taxing authority to unravel the device and to determine the true character of the relationship. But the legal effect of a transaction cannot be displaced by probing into the 'substance of the transaction'. This principle applies alike to cases in which the legal relation is recorded in a formal document and to cases where it has to be gathered from evidence-oral and documentary-and conduct of the parties to the transaction. [449B]

Commissioner of Income-tax, Gujarat v. B. M. Kharwar, 72 I.T.R. 603 followed.

Sir Kikabhai Premchand v. Commissioner of Income-tax (Central), Bombay, 24, I.T.R. 506, Commissioner of Income-tax, Bombay City v. Sir Homi Mehta's Executors, 28 I.T.R. 928, Rogers & Co. v. Commissioner of Income-tax, Bombay City-II, 344, I.T.R. 336 and Commissioner of Income-tax (Central) _Calcutta v. Mugneeram Bangur and Company. 47, I.T.R. 565, referred to.

In the instant case, the Tribunal had held that the agreement for sale' entered into between the assessee firm and 'company' was a genuine transaction and the same evidenced a sale. This was essentially a fin ding of fact and the High Court had affirmed that finding. In that view the contention of the Revenue that the transaction in question was an exchange and not a sale and the contention of the assessee that it was mere adjustment, cannot be accepted.

Cl. (1) of the agreement in specific terms said that "the existing partners shall sell and the company shall purchase the shares and securities for a sum of rupees seventy-five lakhs. Clause (3) of that agreement merely provided a mode of satisfaction of the sale price. The sale price fixed by the parties for the shares and the securities sold was 75

lakhs and nothing more. It may be that because of the allotment of the shares of the Company in satisfaction of the sale price the assessee firm got certain benefits but that did not convert the sale into an exchange. [449 E]
Commissioner of Income-tax, Kerala v. B. R. Ramakrishna Pillai, 66, I.T.R. 725 and Commissioner of Income-tax, West Bengal and any. v. George Henderson & Co. Ltd. 59 I.T.R. 238, referred to.
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For the above reasons it must be held that the transaction evidenced by the agreement for sale between the company and the assessee was a sale.
(iv) Under s. 12-B(2) the amount of capital gains has to be computed after making certain deductions from the 'full value' of the consideration for which the sale is made. In the case of a sale for a price, there is no question of any market value unlike in the case of an exchange. Therefore, in cases of sales to which the first proviso to sub-s.(2) of s. 12-B is not attracted all that has to be seen is the consideration bargained for. On the facts of the present case the first proviso was not attracted. The price bar-gained for the sale of the shares and securities was only rupees seventy-five lakhs. The High Court rightly held that the capital gains amounted to Rs. 274,772. [450 C]
Commissioner of Income-tax, West Bengal and Anr. v. George Henderson and Co. Ltd., 66 I.T.R. 622, followed.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 1452 & 1502 of 1969.

Appeals by certificate from the judgment and order dated September 13, 1968 of the Calcutta High Court in Income-tax Reference No. 101 of 1966.

S. C. Manchanda, B. B. Ahuja, S. P. Nayar and R. N. Sach- they, for the appellants (in C. A. No. 1452/69 and for respondent (in C. A. No. 1502/69).

D. Pal, T. A. Ramachandran and D. N. Gupta, for the respondent (in C. A. No. 1452/69) and the appellant (in C. A. No. 1502/69).

The Judgment of the Court was delivered by HEGDE, J. These are cross-appeals by certificate. They arise from the decision of the Calcutta High Court in a Reference under s. 66(1) of the Indian Income-tax Act, 1922 (to be hereinafter referred to as the Act). At the instance of the assessee as well as the Commissioner, the Income-tax Tribunal 'B' Bench, Calcutta stated a case and submitted as many as five questions to the High Court for obtaining its opinion. Some of the questions referred to the High Court have not been passed before this Court. Therefore we shall not refer to them. The questions that were pressed before us are :

"(1) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the proceedings under section 34 (1)(a) have been validly initiated ?

(2) Whether on the facts and in the circumstances of the case, any capital gains within the meaning of Section 12-B could be said to arise by the transaction involving transfer of the invest-

ments held by the assessee to the Company, admission of the Company as a partner in the assessee firm and issue of shares of the Com- pany to the public; and (3) Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in computing the capital gains at Rs. 46,76,784/-?"

The High Court answered the first question in the affirmative and in favour of the Revenue. So far as the second question is concerned, it split the same into two questions viz. whether on the facts and in the circumstances of the case any capital gains within the meaning of s. 12-B could be said to arise by the transaction involving transfer of investments held by the assessee to the Company and whether on the facts and in the circumstances of the case any capital gains within the meaning of s. 12-B could be said to arise by the admission of the Company as a partner in the assessee firm and issue of shares of the Company to the public ? It answered the first part of the question in the affirmative and in favour of the Revenue and the second part in the negative and against the Revenue. As regards the 3rd question, the High Court opined that on the facts and in the circumstances of the case, the capital gains should have been computed at Rs. 27,04,772/-. Aggrieved by this decision the Commissioner of Income-tax has brought Civil Appeal No. 1452 of 1969 and the assessee has brought Civil Appeal No. 1502 of 1969.

The only contentions urged in the assessee's appeal were that ,on the facts and in the circumstances of the case proceedings under s. 34 (1) (a) have not been validly initiated and to the facts of this case s. 12-B is not attracted. In the appeal by the Commissioner, the question for decision is what is the correct amount that has to be brought to tax under S. 12-B as capital gains. The Counsel for the Revenue did not contest the conclusion of the High Court that on the facts and in the circumstances of the case, no capital gains within the meaning of S. 12-B could be said to have arisen by the admission of the Company as a partner of the assessee company and issue of shares of the Company to the public. Hence all that we have to decide in these cases is (1) whether the proceedings initiated under S. 34 (1) (a) are valid, (2) Whether S. 12-B is attracted to the facts of the case and (3) If S. 12-B is attracted what is the amount of the ,capital gains made ? For pronouncing on the questions above-formulated, it is necessary to set out the material facts. The assessee is a registered firm which was carrying on business mostly as managing agents of number of companies. Till the end of February 1947, the firm consisted of four partners namely (1) A.C. Gladstone; (2) S. D. Gladstone; (3) T. S. Gladstone and (4) Glendye Limited., each of them having, 30%, 39%, 30% and 1% shares respectively in the

profits of the firm. We are concerned with the assessment of the assessee firm for the assessment year 1947-48 for which the previous year was the financial year ended on March 31, 1947. On February 28, 1947, the assessee firm through its partners entered into an "agreement for sale" of some of the shares and securities hold by it in favour of Gillanders Arbuthnot & Co. (to be hereinafter referred to as the "Company") for a sum of Rs. 75 lakhs. The shares and securties sold under the document are enumerated at the foot of the document. Clause (2) of that agreement provides :

"In consideration of the sum of Rupees Fourteen Lakhs and Ninety thousand the existing partners shall admit the company as a partner in the firm upon and subject to the partnership deed (a draft whereof has been already approved by the existing partners and the company), the share of the company in the goodwill and in the profits of the Finn being ninety-nine per cent thereof."

The only other clause which is relevant for our present purpose is clause (3) which reads :

"The said two sums of Rupees Seventy-five lakhs and Rupees Fourteen lakhs and Ninety thousand payable in accordance with Clauses 1 and 2 hereof shall be paid and satisfied as follows

(a) As to the sum of Rupees Sixty-four lakhs and Ninety thousand by an allotment to the existing partners or their nominees of sixty-four thousand and nine hundred Ordinary Shares of rupees One hundred each credited for all purposes as fully paid up.

(b) As to the sum of Rupees Twenty-five lakhs by an allotment to the existing partners or their nominees of Twenty-five thousand Redeemable Cumulative Preference Shares of Rupees One hundred each credited for all purposes as fully paid up."

One other document that came into existence on the same Jay viz. Feb. 28, 1947 is the deed of partnership. That day the assessee firm was reconstituted and a new partnership came into existence. The new partnership consisted of five partners viz. (1) The "company"; (2) A. C. Gladstone; (3) S. D. Gladstone (4) T. S. Gladstone and (5) Glendy Limited. In this new partnership the "Company" had 99 per cent share in its profits. The remaining four, partners had only 1/4th per cent share each in the profits of the new partnership. Before proceeding further, it is necessary to mention that the "Company", was previously a private Ltd. Company. In 1946 the "Company" applied to the Examiner of Capital Issues for permission to convert itself into a Public Ltd. Company and sell its shares at a premium. Originally the proposal of the "Company" was to sell its shares of the face value of Rs. 100/- to the public at a premium of Rs. 145 to Rs. 175/- and its preferential share of the face value of Rs. 100/- at a premium of Re. 1 to 5. The Examiner of Capital Issues did not agree to that proposal. Later on after further correspondence, the Examiner of Capital Issues permitted the "Company" to convert itself into a Public Company and offer its ordinary shares of the face value of Rs. 100/"- to the public at a premium not exceeding Rs. 125/- per share and 25,000/-

Redeemable Cumulative Preference Shares of the face value of Rs. 100 each ,it a premium -not exceeding Rs. 51- per share.

We have earlier noticed that a substantial number of ordinary as well as the preference shares were transferred to the assessee firm at its face value.

The, original assessment of the assessee firm for the assessment year 1947-48 was made on August 28, 1948 on a total income of Rs. 12,90,829/- Thereafter the Income-tax Officer initiated proceedings under s. 34 (1) (a) on May 2, 1949 and completed the fresh assessment on January 16, 1956 bringing to charge capital gains determined at Rs. 1,03,16,786/-. The assessee appealed to the Appellate Assistant Commissioner. It raised various contentions before the Appellate Assistant Commissioner. It is not necessary to refer to those contentions. Suffice it to say for our present purpose that it challenged the validity of the initiation of the proceedings under s.34(1) (a) and further it contended that there was no capital gain at all. On the other hand it claimed that it incurred certain capital loss. The Appellate Assistant Commissioner rejected the contention of the assessee that the proceedings under S. 34 (1) (a) were not validly initiated. He came to the conclusion that there were capital gains but he computed the same at Rs. 70,9.124/-. On further appeal by the assessee the Tribunal came to the conclusion that the capital gains made by the assessee were only ,Rs. 46,76,784/-. In the Reference mentioned earlier, the High Court came to the Conclusion that the capital gains made by the assessee were Rs. 27,04,772/-.

The first question that arises for decision is whether s. 34(1) (a) proceedings were validly initiated by the Income- tax Officer. That provision says :

> "If the Income-tax Officer has reason to believe that by reason of the omission or failure on the part of an assessee to make a return of his income under section 22 for any year or to disclose fully and truly all material facts necessary for his assessment for that year, income, profits or gains chargeable to income-tax have escaped assessment for that year or have been under- assessed, or assessed at too low a rate, or have been made the subject of excessive relief under the Act, or excessive loss or depreciation allowance has been computed.....
>
> In the present case all that we have to see is whether the In come-tax Officer had reason to believe that the assessee had not disclosed fully and truly all the material facts necessary for its assessment for the assessment year in question. The scope of the expression "failure on the part of the assessee..... to disclose fully and truly all material facts necessary for his assessment has been examined by this Court in several decisions. The leading case on the subject is Calcutta Discount Co. Ltd. v. Income-tax Officer, Companies District-1, Calcutta and anr.(1) Therein this Court by majority held that to confer jurisdiction under s. 34 to issue notice in respect of an assessment beyond a period of four years, but within a period of eight years, from the end of the relevant year, two conditions have to be satisfied. The first is that the Income-tax Officer must have reason to believe that the income, profits or gains chargeable to income-tax had been under-assessed; the second is that he must have

> reason to believe that such "under-assessment" had occurred by reason to either (1) omission or failure on the part of the assessee to make a return of his income under s. 22 or (2) comission or failure on the part of the assessee to disclose fully and' truly all material facts necessary for his assessment for that year. Both these conditions are conditions precedent to be satisfied before the Income-tax Officer gets jurisdiction to issue a notice for the assessment or reassessment beyond a period of four years but within a period of eight years from the end of the year in question. This Court further ruled therein that the words "omission or failure to disclose fully and truly all material facts necessary for his assessment for that year"

used in s. 34 postulate a duty on every assessee to disclose fully and truly all material facts necessary for his assessment. What facts are material and neces- (1) 41 I.T.R. 191.

-L498SupCI/73 sary for assessment differs from case. In every assessment proceeding, the assessing authority would for the purpose of computing and determining proper tax due from an assessee, require to know all the facts which help him in coming to the correct conclusion. From the primary facts in his possession whether on disclosure by the assessee or discovered by him on the basis of the facts disclosed or otherwise, the assessing authority has to draw inferences as regards certain other facts; and ultimately from the primary facts and further facts inferred from them, the authority has to draw the proper legal inferences and ascertain, on a correct interpretation of the taxing enactment, the proper tax leviable So far as the primary facts are concerned, it is the assessee's duty to disclose all of them-including particular entries in the account-books, particular portions of documents and documents and other evidence which could have been discovered by the assessing authority from the documents and other evidence ,disclosed. The duty, however, does not extend beyond the full and truthful disclosure of all primary facts. Once all the primary facts are before the assessing authority, it is for him to decide what inferences of facts could be reasonably drawn and what legal inferences have ultimately to be drawn. It was not for anybody ,else-far less the assessee-to tell the assessing authority what inferences whether of facts or of law should be drawn. If there are in fact some reasonable grounds for the Income-tax Officer to believe that there had been any non-disclosure as regards the primary facts which, could have a material bearing on the question of under-assessment that would be sufficient to give jurisdiction to the Income- tax Officer to issue the notice under s. 34. Whether those grounds were adequate or not for arriving at the ,conclusion that there was a non-disclosure of material facts is not open to the court's investigation. In other words, all that is necessary to give jurisdiction is that the Income-tax Officer had when he assumed jurisdiction some prima facie grounds for thinking that there had been some non-disclosure of material facts.

The rule laid down in Calcutta Discount Co.'s case (supra) was reiterated by this Court in Commissioner of Income-tax West Bengal and anr. v. Hemchandra Kar and ors. (1). The same view was again expressed by this Court in Commissioner of Income-tax Gujarat v. Bhanji Lavji(2) as well as in Commissioner of Income-tax Calcutta v. Burlop Dealers Ltd.

Bearing in mind the rule laid down in these decisions now let us proceed to examine the facts of this case to find out whether the assessee had failed to disclose fully and truly all material facts for his

assessment for the assessment year in question. In this (1) 77 I.T.R. p. 1.

(2) 79 I.T R. 583.

(3) 69 I.T.R. 609.

case we are dealing with capita gains. Hence the material facts that had to be disclosed were those bearing on capital gains. Though at the time of the original assessment of the assessee, the partnership deed entered into by the five partners was before the Income-tax Officer, the sale deed executed by the partners of the assessee firm in favour of the "Company" on February 28, 1947 had not been placed before him. There was no material before the Income-tax Officer on the basis of which he could have concluded that the assessee firm had sold any shares and securities to the "Company"; nor was there any material before the Income-tax Officer as to the value of those shares and securities as on January 1, 1939. Further no material was placed before him to show that those shares and securities had been sold to the "Company" for a sum of Rupees 75 lakhs. In fact the assessee submitted its return for the assessment year in question in an old form which did not contain Pt. VII which dealt with particulars of income from capital gains. The statement enclosed also did not contain specific particulars about consideration for the sale of goodwill or for the sale of shares of the "Company". It is not without significance that the assessee did not challenge the validity of the proceedings under s. 34 (1) (a) before the Income-tax Officer. Even before the Appellate Assistant Commissioner, the only point that appears to have been urged was that since the firm was reconstituted and the reconstituted firm was granted registration under s. 26-A in the assessment year 1947-48, it should be presumed that the Income-tax Officer while making the original assessment was aware of all the material facts. We agree with the Tribunal and the High Court that there is hardly any doubt that the assessee had failed to disclose fully and truly all material facts for the purpose of ascertaining whether it had made any capital gains or not.

This takes us to the question whether the assessee had made any capital gains in the relevant accounting year, if so, what is the extent of its capital gains. The provision relating to capital gains is found in s. 12-B. We shall now read the relevant portion of that provision.

> "S. 12-B(1). The tax shall be payable by an assessee under the head "Capital Gains" in respect of any profits or gains arising from the sale, exchange, relinquishment or transfer of a capital asset effected after the 31st day of March, 1956, and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange, relinquishment or transfer took place".

[The provisos to sub-s. (1) are not relevant for our present purpose].

Sub-1. (2) of S. 12-B says :

> "The amount of a capital gain shall be computed after making the following deductions from the full value of the consideration for which the sale, exchange, relinquishment or transfer of the capital asset is made namely :

(i) expenditure incurred solely in connection with such sale, exchange, relinquishment or transfer

(ii) the actual cost to the assessee of the capital asset, including any expenditure of a capital nature incurred and borne, by him in making any additions or alterations thereto, but excluding any expenditure in respect of which any allowance is admissible under any provision of sections 8, 9, 10 and 12;

Provided that where a person who acquires a capital asset from the assessee, whether by sale, exchange, relinquishment or transfer is a person with whom the assessee is directly or indirectly connected and the Income-tax Officer has reason to believe that the sale, exchange, relinquishment or transfer was effected with the object of avoidance or reduction of the liability of the assessee under this section, the full value of the consideration for which the sale, exchange, relinquishment or transfer is made shall, with the prior approval of the Inspecting Assistant Commissioner of Income-tax be taken to be the fair market value of the capital asset on the date on which the sale, exchange, relin-

quishment or transfer took place."

(The remaining portion of s. 12-B is not relevant for our present purpose).

The Income-tax Officer opined that the market value of the shares and securities sold was much more than Rs. 75 lakhs. Admittedly their original cost on January 1, 1939 was Rs. 47,95,728/Hence according to him, the "Company" secured those shares and securities at below market value. The Income-tax Officer further observed that the partners of the assessee firm were the sole partners of the "Company" and further held that the sale had been effected at a lower price with the object of reducing the liability to capital gains tax. On the basis of the Income-tax Officer's computation, the capital gains on the sale of the investments were Rs. 75,86,960/-. As regards the, goodwill the Income-tax Officer valued the same as on January 1, 1939, at Rs. 87,56,200/and 99 per cent thereof would work out to be Rs. 86,67,648/-.

The assessee received for goodwill the sum of Rs. 14,90,000/' The Company took over 99 per cent of the capital deficiency of the partners amounting to Rs. 19,98,849/- and 99 per cent thereof came to Rs. 19,78,861/-. The Income-tax Officer estimated the value of 99 per cent of the goodwill at Rs. 1,13,97,474/ involving capital gain of Rs. 27,29,826/-. Thus according to the Income-tax Officer the total capital gains on account of transfer of shares and securities and goodwill amounted to Rs. 1,3,16,786/-. As seen earlier this amount was substantially reduced by the Appellate Assistant Commissioner and again by the Tribunal as well as by the High Court.

The first question for decision is whether the first proviso to s. 12-B is attracted to the facts of the present case. The sale with which we are concerned in this case took place on February 28, 1947. Section 12-B was incorporated into the Act with effect from April 1, 1947. That being so at the time the sale transaction took place s. 12-B was not a part of the Act. Hence there is no basis for saying that the "transfer was effected with the object of avoidance or reduction of the liability of the

assessee" see Commissioner of Income-tax, West Bengal and anr. v. George Henderson and Co. Ltd.(1). Hence the question for decision is whether the facts of this case fall within the scope of s. 12-B(1) read with sub-s. (2) of that section. We have earlier seen that the Income-tax Officer in computing the total capital gains had taken into consideration the capital gains said to have been earned as a result of the sale of the shares and securities as well as the goodwill. The Appellate Assistant Commissioner in his order did not say anything specific about any capital gains earned as a result of the sale of the goodwill. The Tribunal rejected the case of the Department that there were any capital gains made as a result of the sale of goodwill. It also rejected the claim of the assessee that there was some capital loss as a result of the sale of goodwill. On this point the High Court agreed with the conclusions reached by the Tribunal. The conclusion of the High Court on this point was not challenged before us either by the Revenue or by the assessee. Therefore there is no need to go into the same. Hence the only question remaining to be considered is whether there were any capital gains made as a result of the transfer of the shares and securities by the assessee to the Company. If so what is that amount ? The first question that we have to decide in this connection is whether the transaction entered into under the agreement for sale dated February 28, 1947 is a sale or exchange or merely a readjustment. It was contended on behalf of the Revenue that it (1) 66 I.T.R. 622.

was in effect an exchange though in form it was a sale. According to the assessee, it was a mere readjustment. The Revenue did not contend before the Appellate Assistant Commissioner or the Tribunal or even the High Court that the said transaction was not a sale. It was for the first time before this Court the contention was taken that it was not a sale. The contention of the assessee that it was merely readjustment had been rejected by the authorities under the Act as well as by the High Court.

Properly understood the effect of the contention of the Revenue as well as of the assessee is that in finding out the true nature of a transaction, the court must take into consideration the substance of the transaction and not the legal effect of the agreement entered into a proposition which receives some support from some of the decided cases. In Sir Kikabhai Premchand v. Commissioner of Income-tax (Central), Bombay(1), this Court observed that "it is well recognised that in revenue cases regard must be had to the substance of the transaction rather than to its mere form". The observations of this Court in Sir Kikabhai Premchand's case (supra) were made the basis of the decision of the Bombay High Court in Commissioner of Income-tax, Bombay City v. Sir Home Mehta's Executors 2 In Rogers & Co. v. Commissioner of Income-tax, Bombay City- 11(3), High Court of Bombay ruled that the transfer of the assets of the firm to the company was substantially and really 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 profits in the commercial sense were made thereby; the transfer of the assets of the firm to the company was, therefore, not a sale.

The same view was taken by the Calcutta High Court in Commissioner of Income-tax (Central), Calcutta v. Mugneeram Bangur and Company (4).

This Court in Commissioner of Income-tax, Gujarat v. B. M. Kharwar(5) , held that the observations in Sir Kikabhai Premchand's case (supra) to the effect that in revenue cases regard must be had to

the substance of the transaction rather than its mere form cannot be read as throwing any doubt on the principle that the true legal relation arising from a transaction alone determines the taxability of a receipt arising from the transaction. The observation in question was considered as casual and that the same was not necessary for the purpose of the case. In Kharwar's case (supra), this Court also disapproved the decisions in Sir Homi Mehta's Executors' case (supra), Rogers' & Co's case (1) 24 I.T.R. 506. (2) 28 I.T.R. 928.

(3) 34 T.T.R. 336. (4) 47 I.T.R. 565.

(5) 72 I.T.R. 603.

(supra) and Mugneeram Bangur & Co's case (supra). Therein this Court ruled that it is now well settled that the taxing authorities are not entitled, in determining whether a receipt is liable to be taxed, to ignore the legal character of the transaction which is the source of the receipt and to proceed on what they regard as "the substance of the matter". The taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. if the parties have chosen to conceal by a device the legislation, it is open to the taxing authority to unravel the device and to determine the true character of the relationship. But the legal effect of a transaction cannot be displaced by probing into the "substance of the transaction". This, principle applies alike to cases in which the legal relation is recorded in a formal document and to cases where it has to be gathered, from evidence-oral and documentary-and conduct of the parties to the transaction.

In the instant case, the Tribunal has held that the "agreement for sale" entered between the assessee firm and the "company" is a genuine transaction and the same evidences a sale. This is essentially a finding of fact. The High Court has affirmed that finding. In that view, we are unable to accept the contention of the Revenue that the transaction in question was an exchange and not a sale. We are equally unable to accept the I contention of the assessee that it was merely a readjustment. Clause (1) of the agreement in specific terms says that "the existing partner shall sell and the company shall purchase the shares and securities for a sum of Rupees seventy five lakhs." Clause (3) of that agreement merely provides a mode of satisfaction of the sale price. The sale price fixed by the parties for the shares and the securities sold is 75 lakhs and nothing more. It may be that because of the allotment of the shares of the Company in satisfaction of the sale price, the assessee firm got certain benefits but that does not convert the sale into an exchange. In Commissioner of Income-tax, Kerala v. R. R. Ramakrishna Pillai(1), this Court distinguishing an exchange from a sale observed that where the person carrying on the business transfers the assets to a company in consideration, of allotment of shares, it would be a case of exchange and not of sale and the true nature of the transaction will not be altered because for the purpose of stamp duty or other reasons the value of the assets transferred is shown as equivalent to the face value of the shares allotted. On the other hand a person carrying on business may agree with a company floated by him that the assets belonging to him shall be transferred to the company for a certain money consideration and that in satisfaction of the liability to pay the money consideration (1) 66 I.T.R. 725.

shares of certain face value shall be allotted to the transferor. In such a case there are in truth two transactions, one transaction of sale and the other a contract under which the shares are accepted in

satisfaction of the liability to pay the price. The fact that as a result of the transfer of the shares of the "Company" to the assessee firm, the latter obtained considerable profits, will not alter the true nature of the transaction-see the decision of this Court in Chittoor Motor Transport Co. (P) Ltd. v. Income-tax Officer, Chittoor(1). For the reasons above stated, we have no hesitation in coming to the conclusion that the transaction evidenced by the "agreement for sale" between the company and the assessee was a sale.

Now let us see what is the impact of s. 12-B(2) on that transaction ? Under that provision, the amount of capital gains has to be computed after making certain deductions from the full value of the consideration for which the sale is made. What exactly is the meaning of the expression "full value of the consideration for which sale is made"? Is it the consideration agreed to be paid or is it the market value of the consideration ? In the case of sale for a price, there is no question of any market value unlike in the case of an exchange. Therefore in cases of sales to which the first proviso to sub-s. (2) of s. 12-B is not attracted, all that we have to see is what is the consideration bargained for. As mentioned earlier to the facts of the present case, the first proviso is not attracted. As seen earlier, the price bargained for the sale of the shares and securities was only rupees seventy five lakhs. The facts of this case squarely fall within the rule laid down by this Court in Commissioner of Income-tax, west Bengal and anr. v. George Henderson & Co. Ltd. (Supra). Therein this Court observed :

> "In a case of a sale, the full value of the consideration is the full sale price actually paid. The legislature had to use the words "full value of the consideration" because it was dealing not merely with sale but with other types of transfer, such as exchange, where the consideration would be other than money. If it is therefore held in the present case that the actual price received by the respondent was at the rate of Rs. 136 per share-the full value of the consideration must be taken at the rate of Rs. 136 per share. The view that we have expressed as to the interpretation of the main part of section 12B(2) is borne out by the fact that in the first proviso to section 12(B) (2), the expression "full value of the consideration"

is used in contradistinc-

(1) 59 IT.R. 238.

tion with "fair market value of the capital asset" and there is an express power granted to the Income-tax Officer to "take the fair market value of the capital asset transferred"

> as "the full value of the consideration" in specified circumstances. It is evident that the legislature itself has made a distinction between the two expressions "full value of the consideration" and "fair market value of the capital asset transferred" and it is provided that if certain conditions are satisfied as mentioned in the first proviso to section 12B(2), the market value of the asset transferred, though not equivalent to the full value of the consideration for the transfer, may be deemed to be the full value of the consideration. To give rise to this fiction the two conditions of the first proviso are

(1) that the transferor was directly or in- directly connected with the transferee, and
(2) that the transfer was effected with the object of avoidance or reduction of the liability of the assessee under section 12B.

If the conditions of this proviso are not satisfied the main part of section 12B(2) applies and the Income-tax Officer must take into account the full value of the consideration for the transfer."

It may be noted that in that case the market value of the shares which were allotted at Rs. 136/- per share was Rs. 620/per share.

Applying the principles enunciated in that decision we think that the full value of the sale price received by the assessee was only rupees seventy five lakhs. That being so, the capital gains made by the company were Rs. 27,4 772/- as held by the High Court.

In the result both these appeals fail and they are dismissed with costs.

K.B.N. Appeals dismissed.