

Surinder Lal Vs. Additional Assistant Controller

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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Dec-06-1985

Reported in : (1986)15ITD740(Delhi)

Judge : S Narayanan, O Jain

Appellant : Surinder Lal

Respondent : Additional Assistant Controller

Judgement :

1. This appeal is directed against the order of the Appellate Controller dated 12-12-1983.

2. Smt. Laxmi Bai, who was the mother of the appellant, had died on 19-4-1977. The appellant being the son and legal representative of the deceased was assessed for payment of estate duty, being the person accountable. Smt. Laxmi Bai had 20 per cent share in a partnership firm running under the name and style of Super Fine Art Dyers, New Delhi.

The Assistant Controller had computed the deceased's share of goodwill of the said firm at Rs. 2,20,312 on the basis of three years' purchase price of average profits. The assessee went up in appeal before the Appellate Controller, who reduced the said amount to Rs. 1,34,395 on the basis of two years' purchase price of average profits. Still aggrieved the assessee has come up in appeal before us.

3. The initial contention of the appellant that there was no goodwill at all or that value of the goodwill was nil cannot be accepted. It appears that the said business had shown increasing profits in the assessment year 1976-77 it had profits of Rs. 2,66,781 which rose to Rs. 6,20,228 in the assessment year 1977-78. In the assessment years 1978-79 and 1979-80 also, the profits were over Rs. 5 lakhs. In the circumstances, it cannot be held that the said business had no goodwill at all or value of the goodwill was nil. It is well established that goodwill of a firm is an asset and on the death of a partner, the interest of the partner in the assets or property passes to his legal representative and not to the surviving partners. It is also well settled that value of the deceased's share in the goodwill of the firm is property passing on his death and is liable to estate duty.

Premchand Jain v. CED [1983] 144 ITR 41 (MP) and CED v. Bansidhar Singhal [1984] 150 ITR 17 (MP) are authorities for such proposition.

That being so, the authorities below were right in holding that share of the deceased in the goodwill is liable to estate duty.

4. It was next contended that the Appellate Controller has erred in computing the value of the goodwill on the basis of two years' purchase price of average profits. The learned counsel for the appellant has contended that the goodwill should be worked out at 1 1/2 times of the purchase value. In that connection reliance has been placed on K.A.Subramaniam v. CED [1962] 46 ITR (ED) 1 (Mad.). In that case, the goodwill of the business carried on by the deceased at 1 1/2 years' purchase was upheld by the Hon'ble High Court of Madras. Their Lordships in that case had observed as follows: A rough and ready method of valuing the goodwill of a business is to take it as being worth one to three years' purchase of the annual profits, such profits being based on the annual average profits of the two to five years immediately preceding the valuation, without making any deduction for interest on capital and owner's services.

5. The above observations would go to suggest that no hard and fast rule had been laid down by their Lordships for computation of the goodwill, rather it suggests that it could be computed on the average annual profits of two to five years immediately preceding the valuation. It further shows that while computing

the goodwill in that manner, deduction for interest on capital and owner's services should not be made. In the instant case, the authorities below have allowed deduction on account of interest on capital and working allowance to the partners. Keeping these facts in view and the profits derived by the firm, we feel that the principle adopted by the Appellate Controller for computation of the amount of goodwill is quite fair and calls for no interference.

6. The Appellate Controller has allowed working allowance to Sh.

Surinder Lal at Rs. 2,000 per month because of his skill and experience. Working allowance to other two male partners was allowed at the rate of Rs. 1,500 per month and the allowance for the deceased was calculated at the rate of Rs. 800 per month. It has been argued on behalf of the appellant that the working allowance allowed by the first appellate authority is insufficient. In view of the facts and circumstances mentioned in the order of Appellate Controller we feel that the working allowance deducted in respect of the male partners is quite sufficient but keeping in view the allowance deducted in respect of other male partners, the allowance allowed to the deceased lady is insufficient and we raise it to Rs. 1,000 per month.

7. It was next argued that there had been fluctuations in profits because the business of the assessee is dependent mainly on the export performance by the textile industry and it is highly speculative in nature. It was, therefore, urged that the deduction on account of interest at the rate of 12 per cent per annum allowed by the Assistant Controller is quite insufficient. It is true that there had been fluctuation in the profits. It also appears that in years subsequent to the death of Smt. Laxmi Bai, the profits had declined and, ultimately, the business has closed down. These facts lend strength to the appellant's version that the business was highly speculative in nature.

The Appellate Controller has also made similar observations in his order. He had, however, allowed deduction of interest at the rate of 12 per cent per annum holding that the yield from gilt edged securities is comparatively lower. While comparing to yield from such securities, we cannot forget that investment in such securities is fairly safe. On the other hand, the investment in the business in

question was highly speculative. Investment in speculative trade or business carries higher rates of interest. In the circumstances, we allow deduction on account of interest at the rate of 18 per cent per annum.

8. The last ground is with respect to the sum of Rs. 70,000 assessed as income from agricultural land. A perusal of the order of the Appellate Controller suggests that such ground was not agitated before him. The learned counsel for the appellant has submitted that the ground was, in fact, raised before the Assistant Controller but he omitted to give any finding on the point and as such the appellant had to move application under Section 61 of the Estate Duty Act, 1953 ('the Act') and his application has been partly allowed by the Assistant Controller and his order on the point has been modified. The contention on the point can be considered only if the modified order of the Assistant Controller comes up before the Tribunal in appeal. As such, this plea is beyond the scope of the instant appeal and we refrain ourselves from expressing any opinion.

2. In the super profits method of valuation of goodwill it is important to deduct from the estimated annual future profit: (a) reasonable remuneration of proprietors and management; and (b) an amount considered to be a reasonable return on the capital invested in the tangible assets. My learned brother has held interest "at the rate of 18 per cent per annum to be a reasonable deduction, keeping in view the nature of the business under consideration here. It is axiomatic that an investor expects a better return on his investment where the risk is great than he would from an investment which is 'gilt edged' and, thus, has little or no risk attached to it. Yorston Smyth and Brown (Advanced Accounting, Vols. 1 and II, Sixth edn., p. 493) are of the view that in the former case in a great risk investment, a reasonable return might be anything from 8 per cent to 20 per cent whereas in the latter (gilt edged) the return would approximate that yielded by the 'Commonwealth Bonds'--4 1/2 per cent. It is the higher return in the former case, according to the learned authors, which compensates for the greater risk taken with the capital invested. They also add that generally a reasonable return on capital invested in the case of trading enterprises is usually about 10 per cent but in particular cases this may be considerably higher but usually it will not be lower.

3. Keeping in view the facts relating to the particular business under consideration here, I am also of the view that it would be reasonable to allow deduction on account of interest at the rate of 18 per cent per annum.

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