

Jamnalal Sons Ltd. Vs. Inspecting Assistant

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Jun-16-1988

Reported in : (1989)29ITD164(Mum.)

Judge : M Ajinkya, J Bengra

Appellant : Jamnalal Sons Ltd.

Respondent : inspecting Assistant

Judgement :

1. The appellant herein is a limited company deriving income from property, business, dividends and interest. We are concerned in this appeal with assessment year 1980-81, the accounting year for which ended on 21-10-1979. The appellant filed its return of income on 29-7-1980 declaring total income at Rs. 5,53,025. It filed a revised return on 28-2-1983 declaring income at Rs. 5,95,690. The IAO of Income-tax (Asst. Range), Nagpur, determined the income of the appellant-company at Rs. 1,25,23,960. This figure of total income included long-term capital gain in respect of transfer of land and shares, the excess value of which was arrived at by the IAC (Asst.), for the detailed reasons given by him in the body of his order at Rs. 1,19,26,177. This assessment was challenged in appeal. The CIT (Appeals) in his order dated 11-11-1985 held that there was a transfer within the meaning of Sections 2(47) and 45 and that the real purpose of the transfer was to convert the personal asset of the partner into money for its own benefit while avoiding the liability to tax on the capital gains. He, therefore, held that there was a transfer for consideration making the surplus liable to tax. In other

words, the appellant was liable to tax on the capital gains arising out of the transfer of capital assets to the firm in the accounting year. The CIT(A) directed the IAC to give the appellant an opportunity to establish its claim for substitution of the value of the capital asset as on 1-1-1964. It is against this finding of the CIT (Appeals) that the present appeal has been filed.

2. Before dealing with the arguments advanced in this regard, certain facts, which are relevant for understanding the issues raised in the appeal, may first be stated. The appellant is a limited company which was incorporated in 1937 and carried on investment business. On 9-4-1979, at the company's Bombay office at Bajaj Bhavan, 226 Nariman Point, Bombay-21, the directors of the company decided to commence a new business activity and as required by Section 149(2A) of the Companies Act, 1956, the Board of Directors further decided to take the approval of the shareholders of the company by a special resolution for commencing¹ the new business activity. An extraordinary general meeting of the shareholders of the company was convened on 23-4-1979 and a special resolution was passed approving the commencement of the new business in accordance with the provisions of Section 149(2A) of the Companies Act, 1956. The special resolution passed by the shareholders at the extraordinary general meeting held at Wardha on 23-4-1979 read as under: RESOLVED that pursuant to and in accordance with the provisions of Section 149(2A) of the Companies Act, 1956 and other applicable provisions, if any, of the said Act the commencement by the Company of the businesses, of importing exporting, selling purchasing or otherwise dealing in all articles, commodities and things of every kind and. description including cotton and of dealing in immovable properties, shares and securities of every nature and description be and the same is hereby approved.

AND RESOLVED FURTHER that the Directors of the Company be and are hereby authorised to commence and carry on the said businesses in such manner as they may be in their discretion deemed fit or proper and either by the company directly or in partnership with any other person or company or otherwise howsoever.

The company addressed a letter to the ITO, A-Ward, Nagpur, on 5-5-1979.

Along with this letter, a copy of the aforesaid special resolution dated 23-4-1979 was enclosed and the ITO was informed that in terms of the aforesaid special resolution the Board of Directors of the company at its meeting held on 2-5-1979 considered the question of commencing the new business. The Board decided to convert, as of that day, certain plots of land owned by the company at Janki Kutir, Santacruz, Juhu, Bombay, and 1000 equity shares of Rs. 100 each of Bajaj Electricals Ltd. into stock-in-trade and not capital investment. The details of the plots of land were communicated to the ITO in Annexure II to the said letter. They covered an area of 14,498 sq. metres (17,334 sq. yards) spread over 16 different plots of land. These details have been reproduced by the ITO in the body of his order. The ITO was also informed that the Board of Directors considered the question of entering into partnership with certain other individuals/companies to carry on business, inter alia, of dealing in shares, securities and properties. Such a firm would be styled as "Bajaj Trading Co.". It was decided to contribute the stock-in-trade in the form of land and shares and an amount of Rs. 2 lakhs as company's contribution as capital in the firm. A partnership was entered into on 8-5-1979 between Jamnalal & Sons Ltd., the appellant herein, and Shri Rahulkumar Kamalnayan Bajaj, Shri Shishirkumar Kamalnayan Bajaj, Shri Ramkrishna Jamnalal Bajaj, Shri Nirajkumar Ramkrishna Bajaj, Shekhar Ramkrishna Bajaj as karta of Shekhar Bajaj (HUF) and Madhur Ramkrishna Bajaj as karta of Madhur Bajaj (HUF). The partnership deed provided that each of the parties had agreed to bring into the said partnership assets in specie as and by way of capital and the appellant was expected to contribute a capital of Rs. 1,23,16,750. Such capital contribution on the part of the appellant-company was described in Clause (5) of the partnership deed as under: Its. 1,20,03,000 in the form of value of plots of lands situated at Juhu.

Rs. 1,13,750 in the form of shares in limited companies and Rs. 2,00,000 in the form of cash to be brought in on or before 30th June, 1979 more particularly described in the Schedule 'A'.

3. It was argued before the IAC that the appellant-company had introduced stock-in-trade as its capital in the firm. Reliance was placed on a decision of the Supreme Court in the cases of CIT v. Bai Shirinbai K. Kooka [1962] 46 ITR 86 and

CIT v. Hind Construction Ltd. [1972] 83 ITR 211." The appellant claimed that the conversion of two plots of land and shares into stock-in-trade and their introduction in specie as capital in the firm of Bajaj Trading Co. did not result in transfer and that, therefore, there was no capital gain exigible to tax. On these facts, the IAC posed three questions for his consideration: (1) whether the act of contribution of land by the appellant to the partnership firm would amount to a transfer of property, (2) whether it would amount to transfer of capital asset or merely a transfer of stock-in-trade, and (3) whether such transfer would attract capital gains tax and, if so, what would be the quantum of such gains. After a very detailed discussion of the issues, the IAC held that there was, in effect, a transfer of capital asset of the company into the partnership firm giving rise to capital gains liable to tax. He further held that this was a transfer for consideration resulting in capital gains which were liable to tax.

4. The matter went in appeal before the CIT (Appeals). The CIT(A) held that (vide para 5 of his order) the conversion of the shares and land into stock-in trade cannot be called a sham or a bogus act. He held the conversion as valid and genuine. The CIT(A) further held that the setting up of the firm could not be called a sham or a bogus act. He took note of the fact that the ITO had granted registration on 28-2-1981 and had made the assessment Under Section 143(3) on the same date. The CIT(A), however, did not agree that the transfer of the land and shares to the firm was a transfer of stock-in-trade. According to him, the assets reverted to their original character as capital assets just before the transfer. The CIT(A) held that the conversion by the appellant of the assets into stock-in-trade is irrelevant inasmuch as the assets were contributed to the firm, not as stock-in-trade but as capital. Thereafter, the CIT(A) proceeded to hold that the transfer of the assets to the firm amounted to a transfer within the meaning of Section 2(47) read with Section 45. However, by virtue of the same decision, the transfer was not for any consideration within the meaning of seq. 48 and therefore no capital gains arose out of these transactions. Therefore, at the conclusion of para 5 of his order, CIT(A) gave a finding that the appellant is not liable to tax on the transfer of the assets to the firm as no capital gain arose.

Thereafter, the OIT(A) proceeded to consider whether the judgment of the Supreme Court in, McDowell & Co. Ltd. v. CTO [1985] 154 ITR 148 would apply. He held that only deliberate and complex tax planning schemes would be affected by that judgment. The decision in IRC v. Duke of Westminster [1936] 19 TC 490 would apply in the case of a single-step tax saving plan. The CIT(A) further held that the contribution of the assets to the firm did not give rise to any capital gains in the light of the decision in Sunil Siddharthbhai v. CIT [1985] 156 ITR 509 (SC). The CIT(A) thereafter proceeded to go through the records of the appellant as well as that of the firm called 'Bajaj Trading Co.' and he held that the appellant had drawn from the firm a sum of Rs. 1 crore in Sept. 1982 and had used it to partly finance its investment in another firm M/s. J.S. Investors & Traders. This drawal of Rs. 1 crore was mainly out of advances received for the sale of plots. Ultimately, at para 12(e), the CIT(A) reached the following conclusion: (e) On a proper appreciation of the facts and circumstances, and of the nature and purpose of the transactions spanning a period of five years (for which details are available), this is not a fit case for looking at the transfer 'in blinkers, isolated from any context to which it properly belongs', per Lord Wilberforce, cited with approval in McDowell's case, p. 155 of the report. This is not a single-step tax planning device as argued by counsel (para 6 ante), but a complex series of transactions spanning a period of years. The step-by-step analysis at para 5 ante would thus be inapplicable in the facts of the case. The only proper course would be to consider the series of transactions in its entirety.

The CIT(A) proceeded to hold that it was clear that the appellant had arranged through this sequence of actions to have access to the moneys arising out of the revaluation while trying to avoid due taxation on the capital gains. The CIT(A) further held that the appellant's case fell squarely within the reservations expressed by the Supreme Court in para 20 of their judgment in Sunil Siddharthbhai's case (supra). The CIT(A) further held that there was a transfer of capital asset which, in the circumstances and facts of this case, would lead to capital gain arising to the appellant and falling to be taxed in this year. At the conclusion of para 14, CIT(A) held that once it is held that there was a transfer within the meaning of Section 2(47) and see. 45 find it is seen that the real purpose of the transfer was only to convert the personal asset of the partner into

money for his own benefit while avoiding liability to tax on the capital gains, it follows that there was a transfer for consideration making the surplus liable to charge.

It is against this finding of the CIT(A) that the appellant has come in appeal before us.

5. Shri N.A. Palkhivala, the learned counsel for the assessee, took us painstakingly through the relevant portions of the CIT(A)'s order. He argued that the conversion of land and shares into stock-in-trade was a genuine act. The partnership was formed precisely for the purpose of trading in land. The trading in respect of stock-in-trade could be done by the partner either by himself or through the firm. Shri Palkhivala then argued that what was brought in by way of capital was stock-in-trade, the value of which was a capital asset. There was nothing to prevent a partner from bringing his stock-in-trade and crediting its value to the capital account. There was difference between capital asset and capital account which was not appreciated, according to Shri Palkhivala, by the departmental authorities. There was no question of any capital gains tax at all because what was credited as capital was only a value of stock-in-trade and if at all there was any transfer, what was transferred was stock-in-trade and not a capital asset. Alternatively and without prejudice, Shri Palkhivala argued that there was no transfer within the meaning of Section 2(47) as there is no sale or exchange when a partner brings in capital.

Definition of "transfer" within the meaning of Section 2(47) in relation to capital asset does not apply when a partner contributes capital to the firm. Section 2(47) contemplates sale, exchange or relinquishment of a capital asset or extinguishment of any rights therein. Shri Palkhivala thereafter argued that there was no intention to avoid payment of capital gains which the assessee could have done by resorting to Section 54E. He further argued that there was no transfer for consideration as laid down by the Supreme Court in Sunil Siddharthbhai's case (supra) as the firm was a registered firm, it was accepted as genuine and had still been functioning as such.

Alternatively and without prejudice to the above argument, Shri Palkhivala argued that even if there was consideration, the partner, namely, Jamnalal & Sons Ltd., had 70 per cent interest in the said firm and one did not expect to make profit out of one's own self.

6. Shri Palkhivala thereafter referred to some of the apparent fallacies in the findings of the CIT(A). In para 5(c), the CIT(A) has observed that he is unable to agree that the transfer was of stock-in-trade. He has further observed that the assets reverted to their original character as capital assets just before the transfer.

Shri Palkhivala argued that it was not correct to hold that when a partner brings in capital, it has to be on capital account. There was nothing to prevent an assessee from contributing the value of the stock-in-trade as his capital to the capital account. Shri Palkhivala then argued that one can deal with stock-in-trade otherwise than as a trading transaction. A man's capital may be his stock-in-trade. He illustrated this argument by pointing out that a grocer can become a partner in a firm by contributing the stock of groceries in which he is dealing as his capital and the value of such stock would constitute his capital. This character of stock-in-trade was not noticed by the CIT(A) when he observed that the conversion by the appellant of the assets into stock-in-trade is irrelevant inasmuch as the assets were contributed not as a stock-in-trade but as capital. Shri Palkhivala then pointed out that the Supreme Court decision in Sunil Siddharthbhai's case (supra) was not applicable in the present case as there was no reconversion to capital asset. The CIT(A), according to Shri Palkhivala, had given the right decision on the wrong grounds.

Shri Palkhivala argued that we have to decide whether this was a genuine transaction actually acted upon or whether this was a bogus artificial scheme which had no existence in reality. The law does not prevent a taxpayer from reducing his tax liability by legitimate means.

In the present case, the transaction is genuine. The firm is genuine.

The CIT(A) has held both the transactions as well as the partnership firm as genuine. The firm is assessed to tax till date. These are the findings of the CIT(A)

and these very findings, according to Shri Palkhivala, preclude him from coming to the conclusion that he finally did.

6.1 Commenting on the final conclusions of the CIT(A) at para 12(d) of his order, Shri Palkhivala argued that there was no harm in the firm taking advances. The conveyance was not executed only to avoid stamp duty which is a normal practice when promoters and builders who deal in real estate. Shri Palkhivala pointed out that [vide para 12(c)] the CIT(A) had at one stage stated that the advances were received for the sale of plots and at a later stage stated that the drawal of Rs. 1 crore could only emanate from the capital of the firm itself which capital had been contributed by the appellant-company by revaluing its investments at the market price. This was clearly a contradiction in terms. It would have had to pay no tax if the firm was not formed at all and the company was avoiding no tax which it was otherwise required to pay. Shri Palkhivala further argued that the decision of the Supreme Court in McDowell & Co. Ltd.'s case (supra) clearly did not apply to the assessee's case because the observations at page 160 were applicable only in cases where a device was adopted to avoid tax and was to be considered in the context of colourable devices which, the Court observed, cannot be part of tax liability but the Court had also observed that tax planning may be legitimate provided it is within the framework of law. Shri Palkhivala argued that in the present case no finding had been given that a bogus or sham partnership had been entered into or that any colourable device adopted. In fact, the CIT(A)'s observations were to the contrary and, therefore, the decision of House of Lords in *Furniss (Inspector of Taxes) v. Dawson* 2 WLR 226, would be more appropriately applicable. This decision discusses all the relevant cases on the subject starting from *W.T. Ramsay Ltd. v. IRC* [1981] 2 WLR 449. Shri Palkhivala argued that the assessee could act as either personally or singly as a dealer or he could act jointly with others. In this case, the firm has dealt in shares and lands as its stock-in-trade. The assessee with his partners has dealt in lands and shares as a business and therefore the conversion of land into stock-in-trade could not be denied. Rebutting the CIT(A)'s observation that there was reconversion of stock-in-trade into a capital asset, Shri Palkhivala argued that it would be erroneous to mix up the term 'capital' of the firm with the term 'capital assets'. The capital of the firm may be invested in the stock-in-trade or capital may be brought into the firm in the

form of stock-in-trade.

7. Shri Palkhivala further argued that the conversion of the capital into stock-in-trade was not a device. 'Device', according to Shri Palkhivala, means a sham transaction or a transaction which has no existence in fact or in law. In the present case, the firm is a genuine firm and has been registered year after year as such. The department has never disputed that the assets in question are the firm's stock-in-trade and the firm has been assessed on that basis. The reservation contained in the decision in the case of Sunil Siddharthbhai (supra) has no application. Finally, Shri Palkhivala argued that Section 45 of the IT Act was amended in 1984 to get over the situation created by the judgment in Bai Shirinbai K. Kooka's case (supra). The same section was amended in 1987 with a view to overcome the situation created by Sunil Siddharthbhai's case (supra). These amendments of 1984 and 1987 have no retrospective effect. Referring to some of the salient facts, Shri Palkhivala pointed out that the withdrawal by the assessee-company from the partnership of amounts was only in the fourth year. Total sale proceeds by that year exceeded Rs. 11 crores. Since the partnership did not require money for the day-to-day activities, it was natural that the partnership withdraws moneys from the firm and invests in other profitable avenues of investment. He clarified that no director of the assessee-company is a relative of any partner or any shareholder of the assessee-firm and no single partner is a substantial shareholder of the assessee-company.

Finally, Shri Palkhivala argued that McDowell & Co. Ltd.'s case (supra) applied only where a sham or unreal transaction is put up by the assessee when in fact and in law the transaction was never intended to take effect commercially.

8. Shri Jetley, on the other hand, argued that the assessee had adopted a device to avoid payment of tax. It was not a case of simple avoidance but a case of evasion of tax. He referred to the sequence of events which have already been narrated in the recital of facts in the preceding para. He pointed out that on 23-4-1979 a special resolution came to be passed by which the commencement by the company of importing, exporting, selling, purchasing or dealing in articles of every kind including immovable properties was approved. On 2-5-1979, another

resolution was passed which enabled the company to enter into a partnership agreement. On 3-5-1979, stamp paper of Rs. 100 was purchased and the partnership deed was entered into on 8-5-1979. Shri Jetley referred us to page 8 of the assessment order where the IAC had pointed out that the company was holding the plots of lands and shares for last several years as its capital assets. The property known as 'Janki Kutir' was purchased more than 40 years back for Rs. 90,573 by Jamnalal Bajaj. It was transferred to Jamnalal P. Ltd. in 1938 and since then the property was all along shown as capital asset in the books of the company. For the first time, it was shown as investment on account of capital contribution to the partnership firm at Rs. 1,23,16,750 which included the value of plot of Rs. 1,20,300 and value of shares of Rs. 1,13,750. Shri Jetley pointed out that these capital assets and their conversion into stock-in-trade was a device. One had to look at the substance of the transaction. The purpose of conversion of the land into stock-in-trade and its contribution in specie as capital to a partnership firm was to recoup the market value of the land without payment of tax. The conversion of land into stock-in-trade took place on 2-5-1979. The resolution to join a partnership firm was passed by the Board of Directors on the same day. The stamp paper for drawing the partnership deed was purchased on 3-5-1979 and the partnership deed was drawn on 8-5-1979. Thus, the land was never held by the company as stock-in-trade. Shri Jetley argued that there was difference between capital asset and stock-in-trade. Stock-in-trade must be used in business which is regularly carried on and the nature of a particular item as a stock-in-trade of business could not be determined with reference to volume, frequency and regularity with which such stock was traded in. The company never had business in real estate. It had income from rent and dividend. It had to pass a resolution on 2-5-1979 to fulfil the requirements of Section 149A of the Companies Act to enable it to start business in real estate. All these resolutions and declarations were self-created self-serving documents and could not be taken at their face value without due scrutiny. For this proposition, Shri Jetley relied on the decision of the Supreme Court in the case of CIT v. Durga Prasad More [1971] 82 ITR 540 at p. 541. He also relied on the Supreme Court decision in McDowell & Co. Ltd.'s case (supra) and drew our attention to the observations of the Supreme Court at pages 152 and 159. Shri Jetley then argued that if the assessee resorted to tax planning and

justified it with reference to judge-made law, then the question whether it is tax planning or a device to avoid tax should also be decided with reference to judge-made law. If the appellant relied on the rationale of the decision of the Supreme Court in Bai Shirinbai K. Kooka's case (supra) in support of its case, the department was entitled to draw support from McDowell & Co. Ltd.'s case (supra) as well as from the relevant observations at page 523 in Sunil Siddharthbhai's case (supra). Shri Jetley then relied on a decision of the Supreme Court in Workmen of Associated Rubber Industries Ltd. v. Associated Rubber Industry Ltd. [1986] 157 ITR 77 and relied on the following observations of the Court: It is the duty of the court, in every case where ingenuity is expended to avoid taxing and welfare legislations, to get behind the smoke-screen and discover the true state of affairs. The court is not to be satisfied with form and leave well alone the substance of a transaction....Avoidance of welfare legislation is as common as avoidance of taxation and the approach in considering problems arising out of such avoidance has necessarily to be the same.

In support of his argument that this was a device to avoid tax, Shri Jetley relied on a more recent decision of the Gujarat High Court in CIT v. Smt. Minal Rameshchandra [1987] 167 ITR 507. In that case, the assessee along with her mother and brother purchased a large plot of land from a group of 15 persons in March 1962. When the assessee purchased the land jointly with her mother and brother, the title to the land was in dispute. The assessee along with her mother and brother transferred the land as their capital contribution to the partnership.

There was an entry in the books that the land had been converted into stock by all the three owners and the value thereof was considered to be Rs. 40 per sq. yd. The three partners contributing land retired from the partnership with effect from 31-8-1970 by executing deed of retirement. The firm had not done any business dealing with land. The Court, while summarising the factual position at page 521, pointed out that the assessee chose to show the land as sold through a partnership firm with the sole purpose of avoiding payment of tax on the huge profit actually earned and received. Shri Jetley sought to draw a parallel from the facts of this case to support his argument that the assessee was engaged in a device. Finally, Shri Jetley relied on two decisions of the Supreme Court in S.P.

Gupta v. President of India AIR 1982 SC 148 and relied on the observations at page 231 and National Textile Workers' Union v. P.B. Ramakrishnan AIR 1983 SC 75 and relied on the relevant observations at page 86.

9. We have considered the submissions made by counsels on both the sides. It must be stated at the outset that the CIT (Appeals) has given certain findings which would appear to be contrary to the final conclusion reached by him. For example, he has held that (vide para 5-a) that the conversion of the land into stock-in-trade cannot be called sham or bogus act; that such conversion was valid and genuine.

He has also held that the firm is genuine, Shri Jetley has attacked these findings of the CIT(A) by invoking Rule 27 of the IT Rules. What we have to consider is whether land and shares held by the limited company since 1938 as capital asset became the stock-in-trade of the limited company by a mere declaration and whether it is necessary that there should be some further evidence that they should have been treated as stock-in-trade by the limited company prior to its contribution as capital to the partnership firm, of which the appellant became a partner. In this context, we feel that the argument of Shri Palkhivala that a person can do business with the stock-in-trade either singly or as a partner of a firm is only an argument of convenience or, alternatively, an argument that begs the question. When it is the case of the appellant that what was transferred as capital was stock-in-trade of the appellant-company, it must be proved to be so before it became stock-in-trade of the firm. The facts before us lead us to an exactly contrary decision. We find, on a careful perusal of the order of the IAC, that the land and shares were all along held by the limited company as its capital assets. What is more important in the present context is that the appellant effected certain sales of land and shares in some of the earlier years and the sale proceeds were invested by the company in Unit Trust in order to reduce the rigour of capital gains tax. This is clear from the fact that the assessee had sold plot Nos. 15 and 20 in Janki Kutir, Juhu, Bombay, on 27-2-1979, to M/s Vikas Builders and Investment Co., Mustafa Building, 2nd Floor, Sir P.M. Road, Bombay, for Rs. 10,20,000. The area of the plots was 1701.07 sq. metres. The book value was Rs. 9,347 and the capital gains in the transaction amounted to Rs. 10,20,000 was invested by the

company in units of Unit Trust of India. These facts are recounted here to drive home the point that the assessee itself was actually aware of the nature of the asset that it had in its possession and the extent of appreciation that had taken place in the value of such assets. These facts are very relevant for considering the conduct of the assessee subsequent to these sales. These facts also indicated that the appellant did sell a part of its land but it sold the land as an investor and not as a trader in land. When the company intended to trade in land, it took certain steps such as passing of special resolution, etc. However, the land and shares were never held by the limited company as their stock-in-trade. They never traded in land ; they never dealt in land ; they never traded in shares and if they intended to trade in land or shares after the partnership firm was formed, that was an event that took place after the so-called conversion of the capital asset into stock-in-trade. In order to establish that what was transferred to the firm was the company's stock-in-trade, there must be, in our opinion, something more than a mere declaration, particularly when the conduct of the assessee in the immediately preceding months, i.e., in February 1979, indicated that the appellant was all along treating the land as its capital asset and not as its stock-in-trade. This aspect of the matter, which was highlighted by the IAC, has been completely ignored by the CIT(A). It is, in this context, also necessary to note that the land in question had gone up in value considerably. The value of the 15 plots of land which was contributed as capital was Rs. 1,20,03,000 against their book cost of Rs. 90,573. It was argued that the assessee may act as a dealer jointly with others. The assessee has not itself, as a limited company, traded in land or shares. Therefore, prior to becoming a partner in the firm of Bajaj Trading Co., the assessee's status as a trader in land had not been established as indeed it could not be because there was hardly a day between the conversion of the land into stock-in-trade and the decision to start trading activity in real estate by forming a partnership so that the conversion took place on 2-5-1979. The decision to commence business in land by entering into partnership was taken on 3-5-1979 and the partnership itself was started on 8-5-1979. In the hands of the limited company, the land remained as a stock-in-trade, if at all, only for a day or two before its contribution as capital to the partnership firm of Bajaj Trading Co. In fact, no specific declaration converting the land from capital asset into stock-in-trade has been brought to our

notice. Even the description in the partnership deed, indicating the appellant's contribution which we have reproduced hereinabove, does not clearly mention that the lands and shares were held by the company as its stock-in-trade. What is contributed in specie as initial capital by Jamnalal & Sons Ltd. is Rs. 1,20,03,000 in the form of value of plots of land situated at Juhu and Rs. 1,13,750 in the form of shares in limited companies and Rs. 2 lakhs in the form of cash. It is nowhere mentioned in the partnership deed or in the schedule attached thereto that any of these was held by Jamnalal & Sons Ltd. as their stock-in-trade. Therefore, except a statement that this was intended to be treated as stock-in-trade, there is nothing before us to come to the conclusion that in the hands of the appellant per se the land constituted the appellant's stock-in-trade and that the appellant as a company intended to trade in the land. When it did sell a few plots of land, it realised a substantial capital gain and to reduce the liability to tax on such capital gains, it made investments in Unit Trust. If all these facts are taken into account, we would accept Shri Jetley's preliminary argument that the conversion of land which was held as capital asset into stock-in-trade was a part of a device.

10. The next question is whether the contribution to the firm was a transfer within the meaning of Section 45. It has been held to be so by the Supreme Court in Sunil Siddharthbhai's case (supra). The contribution of land and shares in specie was a transfer of capital asset. The next and the most important question is whether such transfer resulted in a capital gain exigible to tax.

11. Shri Jetley argued that the whole series of transactions was a device to recoup the value of the land which the company possessed and which shot up considerably during a period of years without having to pay tax. Shri Palkhivala, on the other hand, argued that this was a bona fide and genuine firm and that the reservation referred to by the Supreme Court in Sunil Siddharthbhai's case (supra) did not hit the assessee's case.

12. Before dealing with this argument, we will reproduce below the relevant observations of the Supreme Court at page 523: We have decided these appeals on the assumption that the partnership firm in question is a genuine firm and not the result of a sham or unreal transaction and that the transfer by the partner of his

personal asset to partnership firm represents a genuine intention to contribute to the share capital of the firm for the purpose of carrying on the partnership business. If the transfer of the personal asset by the assessee to a partnership in which he is or becomes a partner is merely a device or ruse for converting the asset into money which would substantially remain available for his benefit without liability to income-tax on a capital gain, it will be open to the income-tax authorities to go behind the transaction and examine whether the transaction of creating the partnership is a genuine or a sham transaction, even where the partnership is genuine, the transaction of transferring the personal asset to the partnership firm represents a real attempt to contribute to the share capital of the partnership firm for the purpose of carrying on the partnership business or is nothing but a device or ruse to convert the personal asset into money substantially for the benefit of the assessee while evading tax on a capital gain.

Shri Palkhivala was at pains to point out that the firm was genuine. It was still-in existence and, therefore, the reservation mentioned by the Supreme Court would not apply in the appellant's case and the CIT(A) was not justified in confirming the assessment of capital gains with reference to the above observations of the Supreme Court.- 13. In the light of the arguments advanced on this issue by both the counsels, we have seen the accounts of the firm and the balance sheet filed before us. The first balance sheet of the firm was drawn as at the end of S.Y. 2036. It showed the total capital brought by the partners at Rs. 2,49,66,750. Such capital consisted of shares of joint stock companies, the value of which was shown at Rs. 1,22,44,770 and the plots of land, the value of which was shown at Rs. 1,20,03,000.

Both together were shown on the assets side as stock-in-trade of the firm at Rs. 2,42,47,770. The firm did not take any loan or raise any finance from banks or any financial institution. It, however, received advances against sale of plots of land amounting to Rs. 10,35,000. In the immediately subsequent year, i.e., in the year ended S.Y. 2037, an amount of Rs. 3,16,750 was paid to the assessee-company although the plots of land remained unsold because the closing stock at the end of this year continued to show the value of the stock-in-trade of plots of land at Rs. 1,20,03,000. The advances against sale of plots had gone up to Rs. 36,45,000. In

S.Y. 2039, an amount of Rs. 1,16,60,000 was paid to the company bringing down the balance in the appellant's capital account to Rs. 20 lakhs. Similar amounts were paid to other partners and these payments were made out of the advances received against sale of plots. Thus, the appellant company had almost recovered the value of its capital which it contributed in specie. In the light of these facts, we have to examine Shri Palkhivala's argument that the reservation mentioned by the Supreme Court above does not apply to the facts of the present case.

14. In this context, we have already underlined the observations of the Supreme Court that where the partnership is genuine, the transaction of transferring a personal asset to the partnership firm represents a real attempt to contribute to the share capital of the partnership firm for the purpose of carrying on the partnership business but a device or ruse to convert the personal asset into money substantially for the benefit of the assessee while evading tax on a capital gain. The above sequence of events shows that the money value of the personal asset of the appellant-company has been substantially recovered out of the advances of the firm within a matter of three years after the year in which capital in kind was contributed by the assessee to the partnership firm. The amount of Rs. 1,16,60,000 is certainly not the share of profits of the appellant. In fact, the appellant-company was incurring losses and its share of loss was being separately debited to its current accounts. Thus, in S.Y. 2038, its share of loss was Rs. 1,63,800. In S.Y. 2039, its share of loss was Rs. 11,27,706 and S.Y.2040 its share of loss was Rs. 1,62,504. The current account showed consistently a debit balance on the one hand and on the other hand the amount was refunded from the capital account in S.Y. 2039 from out of the advances received from sale of land. Shri Palkhivala took the argument that the company found it prudent to utilise the funds elsewhere more profitably and therefore there was nothing wrong in withdrawing the amounts from out of the advances. We are not here doubting the intention of the company or questioning "its purpose in withdrawing the amounts from its capital account. We are only concerned with the effect of such withdrawals in the light of the previous conduct of the appellant and other prevalent circumstances and the sequence of events which may be briefly recapitulated. The appellant company has been holding this land as its capital since 1938. In 1979, when it sold a couple of plots out of the land held by it, it realised that the land had

gone up considerably in value. This realisation came to the appellant in February 1979 when a few plots were sold resulting in capital gains of Rs. 10 lakhs and necessitating the investment of the amount in Unit Trust to mitigate the rigour of capital gains tax.

It still had 15 other plots. It, therefore, decided to embark upon a scheme, as a part of which it passed a special resolution on 23-4-1979.

It allegedly converted the capital asset into stock-in-trade on 2-5-1979, purchased the stamp paper for forming a partnership firm on 3-5-1979 got a resolution passed by its Board of Directors on the same date for enabling them to start dealing in land and formed a partnership firm on 8-4-1979. The firm had as its capital only land and shares held by the limited company and other members of the Bajaj family as its capital. The stock in trade of the firm was the land and shares. The first accounting period was only a period of 5 months of S.Y. 2036. In S.Y. 2039, i.e., effectively in the third accounting year, the capital account of the company was reduced by a substantial amount of Rs. 1,16,00,000 and the capital balance was reduced to Rs. 20 lakhs even when the current account was showing debit balance on account of loss incurred from year to year. On these facts, it is difficult to accept Shri Palkhivala's argument that this was not a device on the part of the assessee to avoid payment of capital gains tax. The total effect of all these transactions is that the company has been able to transfer the land, which it held as a capital asset, to another entity, i.e. the partnership firm, and has managed to obtain substantially the market value of such land even without having to pay tax on it. It is not necessary for us to go into the realm of what would have happened if the company had not formed the partnership. Even assuming for a while that the firm was not formal, the company would still have had to pay tax whenever it realised the substantially increased market value of its main asset, namely, the land or lock up a substantial amount of sale proceeds in specified investments to avoid capital gains tax.

15. It is necessary to deal with some of the important cases to which very frequent reference was made by counsels on either side. Shri Palkhivala firstly relied on Bai Shirinbai K. Kooka's case (supra). In that case, the question posed by the

Supreme Court was how should the profit made by the assessee by sale of her shares as a trading activity be computed, it being not in dispute that there was in this case a real sale resulting in actual profits. In that case, the High Court emphasized that in order to arrive at real profit one must consider the accounts on commercial principles and construe profits in the normal and natural sense and it then pointed out that what the shares cost originally to the assessee when she had no business or trading activity could not in a commercial sense be said to be the cost of shares to the business which started on 1-4-1945. The High Court held that the market value when the trading activity started should be treated as the cost of the shares in which trading took place and this view was confirmed by the Supreme Court. At page 95 of the report, the Hon'ble Supreme Court observed as under: We think that the approach of the High Court was correct and normally the commercial profits out of the transaction of sale of an article must be the difference between what the article cost the business and what it fetched on sale. So far as the business or trading activity was concerned, the market value of the shares as on April 1, 1945, was what it cost the business. We do not think that there is any question of a notional sale here. The High Court did not create any legal fiction of a sale when it took the market value as on April 1, 1945, as the proper figure for determining the actual profits made by the assessee. That the assessee later sold the shares in pursuance of a trading activity was not in dispute ; that sale was an actual sale and not a notional sale ; that actual sale resulted in some profits. * * * * the only fair measure of assessing trading profits in such circumstances is to take the market value at one end and the actual sale proceeds at the other, the difference between the two being the profit or loss, as the case may be.

It is clear from these observations that there was effective trading activity on the part of the assessee in that case and the question decided by the Bombay High Court and the Supreme Court was how to determine the profit from such trading activity. The Supreme Court held that when there was a trading in shares, the market value of the shares at the beginning of the year in which the trading started was the cost of such shares for determining the trading profits. We do not understand how this decision can help the appellant. We have already pointed out that the shares were all along held as capital asset and there was no trading in shares "by the appellant-company. In fact, the appellant had to take certain steps

like passing resolutions and forming partnership firm in order to commence on a trading activity which was carried out not by the appellant but by the firm of Bajaj Trading Co. In our opinion, therefore, the decision of the Supreme Court in Bai Shirinbai K. Kooka's case (supra) does not advance the case of the appellant. Shri Palkhivala placed considerable reliance on two English decisions, namely, Furniss's case (supra) and W.T. Ramsay Ltd.'s case (supra). We have carefully gone through both these decisions. In fact, in the main judgment of Lord Brightman in Dawson's case, there is a reference to W.T. Ramsay Ltd.'s case (supra). In that case, George Dawson, together with his wife and two sons, held shares in two companies and transferred them to another company called Wood Bastow Holdings Ltd. The transaction of transfer of shares was carried out through an intermediary company which was formed in the Isle of Man in which a new company was created for a short while called Greenjacket Investments Ltd. All this scheme was entered into for the purpose of tax deferment. After discussing all the facts and the relevant cases on the issue, Lord Brightman observed as under: My Lords, in my opinion the rationale of the new approach is this.

In a preplanned tax saving scheme, no distinction is to be drawn for fiscal purposes, because none exists in reality, between (i) a series of steps which are followed through by virtue of an arrangement which falls short of a binding contract, and (ii) a like series of steps which are followed through because the participants are contractually bound to take each step seriatim. In a contractual case the fiscal consequences will naturally fall to be assessed in the light of the contractually agreed results. For examples, equitable interests may pass when the contract for sale is signed.

In many cases equity will regard that as done which is contracted to be done. Ramsay says that the fiscal result is to be no different if the several steps are preordained rather than precontracted. For example, in the instant case tax will, on the Ramsay principle, fall to be assessed on the basis that there was a tripartite contract between the Dawsons, Greenjacket and Wood Bastow under which the Dawsons contracted to transfer their shares in the operating companies to Greenjacket, and under which Greenjacket simultaneously contracted to transfer the same shares to Wood Bastow for a sum in cash. Under such a tripartite

contract the Dawsons would clearly have disposed of the shares in the operating companies in favour of Wood Bastow in consideration of a sum of money paid by Wood Bastow with the concurrence of the Dawsons to Greenjacket. Tax would be assessed and the base value of the Greenjacket shares calculated.

Accordingly, Ramsay says that this fiscal result cannot be avoided because the preordained series of steps are to be found in an informal arrangement instead of in a binding contract. The day is not saved for the taxpayer because the arrangement is unsigned and contains the magic words 'this is not a binding contract'.** ** ** In the instant case the inserted step was the introduction of Greenjacket as a buyer from the Dawsons and as a seller to Wood Bastow. That inserted step had no business purpose apart from the deferment of tax, although it had a business effect. If the sale had taken place in 1964 before capital gains tax was introduced, there would have been no Greenjacket.

The result of correctly applying the Ramsay principle to the facts of this case is that there was a disposal by the Dawsons in favour of Wood Bastow in consideration of a sum of money paid with the concurrence of the Dawsons to Greenjacket. Capital gains tax is payable accordingly. I would therefore allow the appeals.

We really do not see how this decision helps the assessee. Even the House of Lords has frowned upon schemes where (as Lord Brightman observed at the beginning of the judgment), the taxpayer who has been fortunate enough to realise a capital profit has gone out into the street and, with the aid of a statute advisers manufactured out of a string of artificial transactions a supposed loss in order to counteract the profit which he has already made. In Dawson's case, the House of Lords, in essence, held that where there is a pre-ordained series of transactions or one single composite transaction, whether or not it includes the achievement of a legitimate commercial, and steps are inserted which have no commercial purpose apart from the avoidance of a liability to tax, the inserted steps are to be disregarded and the end result considered in the light of the relevant taxing statute. This would only mean that the mere fact that an arrangement is legal or genuine is not enough if such arrangement is embarked upon with a

predetermined object of circumventing the provisions of fiscal statute.

The decision in Dawson's case as well as in W.T. Ramsay Ltd.'s case (supra) was followed by the Chancery Division in *Ingram v. IRC* [1985] Simon's TC 835. The facts in this case were briefly these. The taxpayer negotiated a price of 145,500 for the purchase of an unencumbered freehold property with vacant possession. With a view to reducing the stamp duty payable on the transfer of the property the following transactions were entered into: (1) The vendor and the taxpayer made an agreement for the lease of the property for a term of 999 years at a premium of 145,000 and an annual rent of 25 (the lease agreement).

(2) The taxpayer agreed to indemnify the vendor against any liability He might incur on the transactions which he would not have incurred on a straightforward sale of the property.

(3) H Ltd. owned and controlled by the partners in the taxpayer's firm of solicitors, contracted to buy the freehold reversion of the property for

500.

(4) H Ltd. agreed a subsale of its interest in the freehold reversion to the taxpayer at a price of

600.

(5) The vendor transferred and H Ltd. confirmed to the taxpayer the property subject to and with the benefit of the terms of the lease agreement (the transfer). The taxpayer presented the transfer for adjudication and the Revenue assessed ad valorem duty on it in the sum of 1,456. The Court held that although stamp duty was a tax on instruments and not on transactions, the Court must ascertain the substance of the transaction effected by the instrument to determine whether that instrument fell within a chargeable category and any duty-payable on it. Further, where a preordained series of transactions was entered into for the purpose of avoiding stamp duty the Court would, disregard steps inserted into that series of transactions which had no business purpose and treat the transactions as a single transaction achieving the preordained end. Applying those principles the transfer

would be treated as accomplishing the transfer of the unencumbered freehold interest to the taxpayer at the agreed price, that being the preordained and when the first step in the series of transactions (i.e., the lease agreement) was taken. The lease agreement would therefore be disregarded and the two sale agreements would be treated as a composite contract for the sale of the property to the taxpayer at 145,600. This is one of the latest decisions on the subject which propounds the same principle enunciated hereinabove.

Applying the ratio of these decisions, we cannot read any other meaning in the various steps taken by the assessee except that they were taken to secure the money value of the land possessed by it without having to pay-tax on it. This motive is evident when we see that there was a withdrawal of Rs. 1,16,00,000 from the capital account on the one hand and accumulated loss of over Rs. 20 lakhs in the current, on the other.

16. The next argument of Shri Palkhivala was that the decision of the CIT(A), if confirmed, would mean giving retrospective effect to the amendments of Section 45 brought about in 1984 and 1987. In our opinion, there is a fallacy in the argument of Shri Palkhivala. Shri Palkhivala's argument is based on the assumption that Bai Shirinbai K. Kooka's case (supra) in any case, applicable. But for the amendment brought about to Section 45 by the Taxation Laws Amendment Act, 1984, with effect from 1-4-1985, the appellant would be entitled to the benefit of this decision. We have already pointed out that the decision in the case of Shirinbai K. Kooka (supra) was given on a different set of facts and circumstances where trading in shares had taken place and the question was how to work out profit on such trading-. The facts there were not in dispute. We have also held that this decision on facts is not applicable to the present case because there is no trading in land as stock-in-trade by the appellant-company per se and therefore the question of treating the market value of the trading asset as the cost of trading asset which was the rationale of the Supreme Court's decision, does not apply to the present case. In view of this finding, the question of making Sub-section (2) applicable Retroactively does not arise. As regards the second argument about the amendment brought about in 1987, our decision is not based on the provisions of Sub-sections (3) to (5) of Section 45 which were introduced with effect from 1-4-

1988 by the Finance Act, 1987. These sub-sections only clarify the position in law as the Legislature always wanted it to be. We are only concerned with finding out whether the ratio of the decision in Svnil Siddharth-bhai's case (supra) applies. The last argument of Shri Pa Ikhivala was that the company could have avoided capital gains by claiming relief Under Section 54E.17. The argument that the appellant could have avoided tax liability by resorting to Section 54E is again an argument of convenience apart from the fact that it skirts the main issue. The rise in land price was phenomenal. The capital gains that the assessee would have earned on sale of land would also have been substantial. In order to avoid the liability under the capital gains tax, it (the company) would have had to make substantial investment in specified assets to get the benefit of Section 54E. This would mean that the company would have been deprived of substantial funds. It would also mean that the company would have had no choice about the use of the funds obtained by the sale of the land. The investment of such sale proceeds would have been circumscribed by the requirements of Section 54E. On the other hand, by following the present system or pattern of transactions, the appellant has managed to secure a substantial portion of the money value of the land for investment or use in whatever manner it wanted to invest or use without having to pay tax on it. Therefore, the argument that the tax could have been avoided by resorting to Section 54E is not a very convincing argument.

18. We have to deal with the facts and the conduct of the appellant-company as is evidenced by the series of steps/resolutions, etc., taken by the department and interpret them to decide whether a liability to capital gains arises. In our opinion, for the reasons stated at length in the preceding paragraphs, it does. We, therefore, hold that there is a transfer of a capital asset. Such transfer was effected when the appellant-company became a partner of Bajaj Trading Co. by contributing capital in specie. The value of the assets transferred was realised by the assessee and in that sense the reservation expressed by the Supreme Court applies. The fact that the amount was realised in the third year does not make any difference to the main finding that the whole transaction was entered into with the intention of recouping the money value of the capital asset. We would, therefore, confirm, for the reasons discussed at length, the order of the CIT (Appeals) and dismiss the assessee's appeal.

