

**Kuttukaran Machine Tools Vs. Cit**

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**Court :** Kerala

**Decided On :** Sep-17-2002

**Reported in :** [2003]131TAXMAN690(Ker)

**Appeal No. :** IT Reference Nos. 302 & 303 of 1997 17 September 2002

**Appellant :** Kuttukaran Machine Tools

**Respondent :** Cit

**Advocate for Pet/Ap. :** P. Balachandran, *for the Assessee* P.K.R. Menon and George K. George, *for the Revenue*

**Judgement :**

**G. Sivarajan, J.**

I.T.R. No. 302 of 1997 is at the instance of the assessee. The Tribunal has referred the following three questions for decision by this court at the instance of the assessee : '

'1. Whether on the facts and in the circumstances of the case the Tribunal was correct in law in holding that there was a transfer of the assets of the firm giving rise to capital gains liable to tax ?

2. Whether on the facts and in the circumstances of the case the Tribunal ought to have held that as the business as a going concern was the capital asset which

was the subject of the transfer and not the individual assets and the gain, if any, on the transfer of the business as a whole had to be computed and brought to tax

3. Whether the Tribunal ought to have held that the cost of acquisition and cost of improvement of the business as a going concern were not ascertainable and so a business as a going concern was not an asset on the transfer of which a liability to capital gains arose ?'

2. I.T.R. No. 303 of 1997 is at the instance of the revenue arising out of the same order of the Income Tax Appellate Tribunal. The following three questions are referred at the instance of the revenue :

'1. Whether, on the facts and in the circumstances of the case, the Tribunal is right in law and fact in holding :

(i) section 50(2) is not applicable to non-depreciable assets such as land

(ii) the assessing officer erred in treating the profits arising on the sale of land as one arising on the sale of short-term capital asset

(iii) the land must be treated as a long-term capital asset and the assessee is entitled to the deduction under section 48(2)

2. (a) whether, on the facts and in the circumstances of the case, the Tribunal is right in law and fact in interfering with the valuation of closing stock and the addition of Rs. 6,33,442

(b) whether, on the facts and in the circumstances of the case and also in view of the fact that the Kuttukaran Machine Tools though not dissolved had ceased to do any business, the Tribunal is right in law and fact in deleting the addition of Rs. 6,33,440 and in not applying the decision of the Supreme Court in ALA firm : [1991]189ITR285(SC)

3. Whether, on the facts and in the circumstances of the case and since the levy of interest under section 234B being mandatory, the assessee is entitled to a hearing before the levy and the Tribunal is right in directing so ?'

3. The matter arises under the Income Tax Act, 1961 (hereinafter referred to as 'the Act'). The assessment year concerned is 1991-92, relevant accounting period ended 31-3-1991. The assessee is a partnership firm carrying on business in the manufacture of machine tools for use in automobile industry. The said business was started in the year 1981. In the year 1990 the partners of the firm had promoted a limited company by name 'Kuttukaran Machine Tools Ltd.' All the partners of the assessee-firm are shareholders of the said company. Thereafter the assessee-firm had sold its business as a going concern as per an agreement dated 1-6-1990 to the said company. The said agreement dated 1-6-1990 was not annexed to the paper book in these two cases. Learned counsel for the assessee produced a copy of the said agreement along with a verified petition on 16-9-2002. We are also told by the counsel for the assessee that the sale deeds as contemplated under clause (4) of the said agreement have been executed subsequently.

4. For the assessment year 1991-92 the assessee filed a return admitting capital gains on the transfer of the land and the block of assets such as building and machinery on the basis of the revalued figure which is entered in the assessee's accounts. The assessee however did not revalue the closing stock. Though the assessing officer had accepted separate valuation of the land and block of assets the assessing officer treated the land as part of the block of assets and declined to grant deduction available to long-term capital assets. Similarly the assessing officer revalued the closing stock by adding gross profit and the difference between the book value and the value as ascertained as profit and assessed the said figure to tax.

5. The assessee in fact had contended before the assessing officer that in the case of the transfer of business as a going concern there is no question of assessing the profit to capital gains tax. The assessee also contended that the land being a separate asset having been acquired by the assessee in the year 1981 it has to be assessed only as a long-term capital asset by granting deductions available under law. Similarly the assessee contended before the assessing officer that since the assessee had sold the closing stock at the book value as per the agreement there is no question of arriving at the market value of

the closing stock and adding the difference as income. Since the assessing officer had not accepted both the contentions, the assessee filed appeal against the said assessment order before the first appellate authority-viz., the Commissioner (Appeals), Kochi. The appellate authority confirmed the assessment on these two points as per order dated 18-1-1995 (Annexure B). The assessee filed second appeal before the Income Tax Appellate Tribunal and raised the very same contentions which have been taken before the authorities below. The Tribunal accepted the contentions regarding the availability of the benefit under section 48(2) of the Act in respect of land and also deleted the addition made on the closing stock. The Tribunal, however, rejected the contention of the assessee that no capital gain tax is exigible in respect of transfer of business as a going concern.

6. The assessee has come up in reference against the finding of the Tribunal that the transaction of sale of assets as a going concern is exigible to capital gain tax whereas the department has come up in reference on the question of deduction available under section 48 in respect of land and the deletion of the addition on account of the closing stock. The department has also sought a reference with regard to the interest levied under section 234A of the Act.

7. We have heard Sri P. Balachandran, learned counsel for the assessee and Sri P.K.R. Menon, learned senior Central Government standing counsel for Taxes appearing for the revenue. As already noted, the assessee has transferred its business as a going concern as per agreement dated 1-6-1990 to the limited company by name 'Kuttukaran Machine Tools Ltd.' The relevant clauses of the said agreement read as follows :

'1. The business of the party of the First Part shall, in its entirety, be taken over and succeeded to by the party of the second part with effect from 1-6-1990 and all the assets and liabilities of the Party of the First Part as on 1-6-1990 and covered by the balance sheet as at the said date prepared for the purpose of the take over will from the said date onwards be the assets and liabilities of the party of the Second Part.

2. The market value of the immovable properties consisting of land and building and forming part of the assets of the party of the First Part as valued by the

approved valuer Sri A.V. James of Trichur and recorded in his report dated 16-4-1990 and the market value of the plant and machinery, equipments, furniture and fixtures forming part of the assets of the Party of the First Part as valued by approved valuer Sri C. Narayanan of Ernakulam and recorded in his valuation report dated 30-4-1990 shall be substituted for the book value of the respective assets and the resultant difference in the value shall be apportioned among the partners as provided for in the partnership deed by which the Party of the First Part was last reconstituted and the balance sheet of the Party of the First Part for the purpose of takeover shall be drawn up accordingly.

3. The ownership of all the assets of the party of the First Part as borne on its balance sheet as at 1-6-1990 drawn up for purpose of take over shall stand transferred to and vest in the Party of the Second Part with effect from 1-6-1990 and the Party of the First Part shall have no manner of claim or right to any of the said assets. The Party of the First Part shall do all acts or things necessary to make the transfer absolute, including registration of a sale deed in respect of the land and building in the appropriate forum of registry'.

8. From a reading of the said clauses particularly clauses (1) and (4) it is clear that the assessee had transferred the business in its entirety as a going concern to the company mentioned above and it also provides that the business will be succeeded to by the said company. Clause (4) further provides that as borne on its balance sheet as at 1-6-1990 drawn up for the purpose of take over shall stand transferred to and vest in the party of the Second Part with effect from 1-6-1990 and the assessee shall have no manner of claim or right to any of the said assets. It further provided that the assessee shall do all acts or things necessary to make the transfer absolute, including registration of a sale deed in respect of the land and building in the appropriate forum of registry.

9. From the aforesaid two clauses it is clear (1) that the entire assets of the assessee-firm was transferred to the company as a going concern with effect from 1-6-1990 and thereafter the assessee had no business and (2) the agreement clearly provided for execution and registration of sale deeds in respect of the land and building. Though it would appear that there was no transfer of the land and

building by registered documents as contemplated under law, in view of the provisions of section 2(47)(v) a transaction falling within section 53A of the Transfer of Property Act will also be transfer for the purpose of section 45 of the Income Tax Act. In the above circumstances, the transaction in question attracts the provisions of section 45(a) of the Income Tax Act. However, the contention of the assessee is that in the case of sale of business as a going concern the profit, if any, arising out of such transaction is not exigible to capital gains. The counsel for the assessee relied on the decision of the Supreme Court in CIT v. Mugneeram Bangur & Co. (Land Department) : [1965]57ITR299(SC) . However, the Tribunal in the instant case has relied on the decision of this court in CIT v. F.X. Periera & Sons (Travancore) (P) Ltd. : [1990]184ITR461(Ker) and the decision of the Supreme Court in CIT v. R.R. Ramakrishna Pillai : [1967]66ITR725(SC) . In fact this court in F.X Periera's case (supra) relied on the decision of the Supreme Court in Alapati Venkataramiah v. CIT : [1965]57ITR185(SC) . Similarly the decision of the Supreme Court in R.R. Ramakrishna Pillai's case (supra) is applicable to the facts of the present case. In view of the aforesaid two decisions, we are of the view that the contention of the assessee that in the case of transfer of business as a going concern the profit arising out of such transaction is not exigible to capital gains cannot be accepted.

10. The three questions referred at the instance of the assessee in ITR No. 302 of 1997 are different facets of the same issue which we have decided hereinabove. In the above circumstances, we answer the said three questions against the assessee and in favour of the revenue.

11. Now we will deal with the question whether the assessee is entitled to deduction as provided under section 48 of the Income Tax Act. The assessee had separately valued the land. The assessing officer also accepted the separate valuation. However, the assessing officer did not grant deduction sought for by the assessee treating the land also as part of the block of assets. The Tribunal has considered this matter. It was noted that there was absolutely nothing on record to show that the value of the land was included in the value of the block of assets. In the above circumstances, noting the fact that this asset was acquired by the assessee in 1981 the Tribunal held that the land must be treated as a long-term

capital asset eligible for deduction as provided under section 48.

12. In the absence of materials produced by the revenue to the effect that the value of the land has also been taken in the block of assets and in the books of account of the assessee we have to accept the finding of the Tribunal. We accordingly hold that the Tribunal has correctly held that the capital gains arising from land in question is entitled to deduction under section 48(2) of the Act. In the above circumstances, we answer question No. 1 in the departmental reference in ITR No. 303 of 1997 in favour of the assessee and against the revenue.

13. The next question arising for consideration is as to whether the Tribunal was justified in deleting the addition of Rs. 6,33,442 being the difference in the value of closing stock as income. As already noted, according to the assessee as per the agreement dated 1-6-1990 the closing stock was transferred for the book value and in such a case there is no question of capital gains and by adding the notional profits as income exigible to tax under the Act. In the instant case we have already found that the assessee had transferred the entire business as a going concern and thereafter nothing remained with the assessee to carry on any business. However, the assessee claimed that the said firm continued for the purpose of realisation of the amounts due from the debtors. In fact we find that the assessing officer had accepted the said stand of the assessee as evident from the fact that the expenses claimed by the assessee for realization of such dues was allowed in the assessment order. It is settled law that a firm cannot exist without a business, for partnership according to section 4 of the Indian Partnership Act is the relationship between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. The decision of the Madras High Court in O.RM.OM.RM.PL. Muthukaruppan Chettiar v. CIT : [1943]11ITR540(Mad) is relevant in this context. The agreement clearly provided that the entire business is transferred as on 1-6-1990. In the above circumstances, there cannot be a firm thereafter in the eye of law.

14. In this context the decision of the Supreme Court in A.L.A. Firm v. CIT : [1991]189ITR285(SC) relied on by the department and by the first appellate authority deserves consideration. In that case the assessee-firm carried on

money-lending business in Malaya and as part of and incidental thereto, a business in purchase and sale of house properties, gardens and estates. The firm closed its accounts as on 13-3-1961 with effect from which date the firm was dissolved. Along with the return filed for the year 1961-62 the assessee had produced a profit and loss account and certain other statements. In the profit and loss account a sum of Rs. 1,01,248 was shown as difference on re-valuation of estates, gardens and house properties. However, this amount was deducted in the adjustment memo for income-tax purposes on the ground that it was not assessable to tax either as revenue or as capital gains. This was practically accepted in the assessment. However, in reassessment proceedings this amount was added to the income earlier brought to tax treating the house properties, gardens and estates as stock-in-trade of the assessee. This was confirmed by the Tribunal. The High Court upheld the Tribunal's order. The Supreme Court observed that the decision of the Madras High Court in *G.A. Ramachari & Co. v. CIT* : [1961]41ITR142(Mad) squarely covers the situation. It is noted that the said decision held that the principle of valuing the closing stock of a business at cost or market price at the option of the assessee is a principle that would hold good only so long as there is a continuing business and that where a business is discontinued, whether on account of dissolution or closure or otherwise by the assessee, then the profits cannot be ascertained except by taking the closing stock at the market value. Comparing the situation of a firm which goes into liquidation where the stock-in-trade and other assets of the business will have to be sold and their value realised the Madras High Court observed that the position is not very different when the partnership ceases to exist in the course of the accounting year. It was further observed that the fact that Ramachari, one of the ex-partners, took over the entire stock and continued to run the business on his own, is not relevant at all when considering the profit or loss of the partnership which has come to an end. The court then observed that it should, therefore, follow that in order to arrive at the correct picture of the trading results of the partnership on the date when it ceases to function, the valuation of the stock in hand should be made on the basis of the prevailing market price. The Supreme Court ultimately held that there can be no manner of doubt that, in taking accounts for purposes of dissolution the firm and the partners, being commercial men would

value the assets only on a real basis and not at cost or at their other value appearing in the books.

15. The Tribunal in the instant case has distinguished the decision of the Supreme Court in A.L.A. Firm's case (supra) and held that in a case where the firm continues even after the transfer of assets there is no question of fixing the market value of the capital share and adding the profit as income exigible to tax. According to us, since the entire business of the firm was transferred to the company the firm came to an end and consequently the principles laid down in the decision of the Supreme Court discussed above applied. The Tribunal has distinguished this decision only on the ground that in the present case the firm continued even after the transfer of the business as a going concern for the purpose of realisation of the dues. This view according to us is not correct.

16. In the above circumstances we hold that the Tribunal was not justified in deleting the addition of Rs. 6 lakhs and odd. We answer the second question referred by the Tribunal at the instance of the revenue in the negative, i.e., in favour of the revenue and against the assessee. Coming to the 3rd question, viz., whether interest can be levied under section 234B the said question is covered by the decision of this court in CIT v. R. Ramalingair (2000) 241 ITR 75. It has been held by this court in R. Ramalingair's case (supra) that the levy of interest under section 234B is automatic. In view of the above, there is no point in affording any opportunity to the assessee. Accordingly, we hold that the Tribunal was not justified in directing the assessing officer to give an opportunity to the assessee on this aspect. Thus we answer question No. 3 referred at the instance of the revenue also in the negative, i.e., in favour of the revenue and against the assessee.

These two income-tax references are disposed of as above.

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