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Court : Chennai

Decided On : Sep-14-1976

Reported in : [1978]111ITR72(Mad)

Appeal No. : Tax Case No. 284 of 1971 (Reference No. 105 of 1971)

Appellant : A. K. D. Dharmaraja

Respondent : Controller of Estate Duty, Madras.

Judgement :

ISMAIL J. - The Income-tax Appellate Tribunal, Madras Bench, under section 64(1) of the Estate Duty Act, 1953, has referred the following questions of law for the opinion of this court :

'1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that in evaluating the share of the deceased in the firm of Indian Reinforcing Company an adjustment on account of the value of the goodwill of the business of the firm was justified.

2. Whether there was material on record to justify the finding of the Tribunal that at the time of the death of the deceased the business of the firm of Indian Reinforcing Company had a goodwill and if so, whether the basis for valuation of the goodwill approved by the Tribunal is proper ?

3. Whether, on the facts and in the circumstances of the case, the Tribunal is right in law in holding that in evaluating the share of the deceased in the firm of Indian Reinforcing Company an adjustment referable to the amount outstanding in the development rebate reserve account in the books of the firm was justified ?'

The deceased, A. K. D. Venkata Raja, who passed away on October 31, 1964, was a partner in the firm of M/s. Indian Reinforcing Company, Madras, with 1/6th share. The firm had a factory at Guindy and the business consisted of manufacture and sale of wiremesh. The property passing on his death was brought to estate duty and the controversy in the assessment to estate duty related to the two items covered by the questions referred to above. One was whether the development rebate reserve statutorily created should be deducted as a liability from the assets of the firm for the purpose of arriving at the 1/6th share of the deceased in the surplus of the assets or not. The second was whether the firm has a goodwill and if it had a goodwill, what is the 1/6th share of the goodwill passing on the death of the deceased. As far as the first point is concerned the contention that was advanced on behalf of the accountable person before the authorities was that the development rebate reserve statutorily created pursuant to the provisions contained in sub-section (3) of section 34 of the Income-tax Act, 1961, is a liability of the firm and, therefore, the same had to be deducted along with other liabilities from the total assets for the purpose of arriving at the surplus of assets over liabilities and calculating 1/6th share thereof of the deceased, and this argument was rejected by the Tribunal. We are of the opinion that the Tribunal was right in so holding. If a partner of the firm dies, the firm is dissolved and the share of the deceased partner in the partnership is arrived at by deducting the total liabilities of the firm from the total assets and arriving at the surplus of the assets and determining the deceased partner's share in the said surplus. In this case, the development rebate reserve was created out of the accumulated profits and it cannot be said to be a liability of the firm. Therefore, it cannot be deducted from the total assets of the firm for the purpose of arriving at the surplus of the assets over the liabilities. This view of ours is supported by a decision of this court in G. Ramaswamy Naidu v. Commissioner of Income-tax : [1972]86ITR768(Mad) . There the questions arose with reference to the determination of the accumulated profits under section 2(22)(e) of the Income-tax Act, 1961. In that context, the

contention that was advanced was that the development rebate reserve is a liability of the business and consequently had to be deducted for the purpose of ascertaining the accumulated profits. This court rejected that contention and observed at page 770 :

'It is true that the amount allowable as development rebate is debited to the profit and loss account and not to the profit and loss appropriation account, but it is not correct to state that it is an expenditure or an outgoing. For ascertainment of the true profits earned by the company the development rebate is not one of the deductible items. Development rebate is only an allowable deduction in the profit and loss account and not intended to set off as any loss or expenditure incurred by the company.'

Thus, it will be seen that the development rebate reserve is not a liability to be deducted from the assets for the purpose of finding out the surplus the assets over the liabilities.

Mr. Swaminathan, the learned counsel for the accountable person, contended that the object of creation of a development rebate reserve under section 34(3) is for the benefit of the undertaking and the industry as a whole and, therefore, it belongs to the industry and not even to all the partners and that, therefore, it cannot be divided as between the partners on the death of any one of the partners.

It is section 34 which deals with the conditions for allowance of development rebate. Sub-section 3(a) of this section says :

'The deduction referred to in section 33 shall not be allowed unless an amount equal to seventy-five per cent of the development rebate to be actually allowed is debited to the profit and loss account of the relevant previous year and credited to the reserve account to be utilised by the assessee during a period of eight years next following or the purposes of the business of the undertaking other than -

(i) for distribution by way of dividend or profits; or (ii) for remittance outside India as profits or for the creation of any asset outside India :'

There are provisos, and it is not necessary to refer to those provisos. It is basing himself on this provision that Mr. Swaminathan contends that the development rebate reserve has to be utilised for the purpose of the business of the undertaking and that, therefore, it must be held to belong to the undertaking and cannot be said to belong to the partners. We are of the opinion that this argument is misconceived. We are not holding that each one of the partners is entitled to have a defined share in each one of the assets of the partnership including the development rebate reserve. As pointed out already, the right of a partner on the dissolution of a firm is to have his share in the surplus of the assets over liabilities of the firm. In this context, all the assets are taken together, and equally all the liabilities are taken together, and it is not as if the partner's share is worked out from each item of the assets and each item of the liabilities separately and one is deducted from the other and, consequently, our conclusion is that the development rebate reserve forms part of the assets of the firm and does not form part of the liabilities of the firm and for the purpose of ascertaining the property passing on the death of the deceased partner, his 1/6th share in the surplus of the assets over the liabilities should be worked out. This view of ours does not in any way militate against the purpose for which the development rebate reserve is statutorily created pursuant to section 34(3) of the Income-tax Act, 1961. Therefore, we hold that the Tribunal was right in this behalf, and, consequently, our answer to the third question is in the affirmative and against the accountable person,

As far as the other two questions dealing with the goodwill are concerned, the first point to be considered is that posed by question No. 2, namely, whether the Tribunal had any material at all to hold that the business had a goodwill. The partnership deed, which was originally entered into between the partners, did not make any reference to the good-will at all. The Tribunal itself found the existence of a goodwill only in paragraph 13 and there the Tribunal states :

'The product manufactured by the firm and placed on the market is somewhat uncommon and it is difficult to say that customers would acquire it with facility from others. Further, from the extent of the profits and all surrounding circumstances, we are of the view that the firm had built up a reputation and it is difficult to say

that there was no goodwill at the stage of the death of the deceased.' It is only this paragraph which deals with the existence of the goodwill. The first point to be considered is whether there was any material for the Tribunal to hold that the product manufactured by the firm was somewhat uncommon and that it is difficult to say that customers would acquire it with facility from others. The Tribunal itself points out in paragraph 2 of its order that on behalf of the accountable person it was stated that there are two other similar factories placing on the market a similar product. The Tribunal does not find against this statement. The product itself is said to be simple wiremesh. It has not been found that the product of the firm in question had a trade-mark of its own which had acquired a reputation in the market. Under these circumstances, it is difficult to see on what material the Tribunal came to the conclusion that the product manufactured by the firm was somewhat uncommon and that it was difficult to say that customers would acquire it with facility from others. Consequently, it is clear that these statement of the Tribunal are not based on any material on record. Apart from this, the only other thing the Tribunal refers to is the extent of the profits. The extent of the profits alone cannot establish the existence of the goodwill. Apart from this, the only other thing the Tribunal refers to is the extent of the profits. The extent of the profits alone cannot establish the existence of the goodwill. Apart from this, the only other reference the Tribunal has made is to 'surrounding circumstances.' But the order the Tribunal itself does not show what these surrounding circumstances are. Under these circumstances, there is no difficulty in holding that Tribunal had no material whatever for coming to the conclusion that the firm had a goodwill. Consequently, our answer to the second question is in the negative and in favour of the accountable person. Once we hold that the Tribunal had no materials to come to the conclusion that the firm of Indian Reinforcing Company had a goodwill, the question of evaluating the deceased's share of the goodwill does not arise. Therefore, our answer to the first question is also in the negative and in favour of the accountable person.

Since the parties have succeeded and lost in part there will be no order as to cost.

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