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IN THE HIGH COURT OF KARNATAKA AT BANGALORE

Dated this the 20th day of July, 2010

PRESENT

THE HON'BLE MR. JUSTICE N KUMAR

AND

THE HON'BLE MRS. JUSTICE B. V. NAGARATHNA

G.T.A. No. 3 of 2005

C/W

G.T.A. No. 4 of 2005 &

G.T.A. No. 5 of 2005

In G.T.A. No. 3 of 2005

BETWEEN:

1 The Commissioner of
Income Tax
C R Building
Queens Road
Bangalore – 560 001

2 The Deputy Commissioner
of Income Tax
Bangalore ...Appellants

(By Sri M V Seshachala, Advocate)

AND:

Smt. Jayalakshmamma
No.337, 18th Cross
Sadashivanagar
Bangalore ...Respondent

(By Sri A. Shankar, Advocate)

This GTA filed under Section 26 of the GTA Act 1958 & 27A of the Wealth Tax Act 1957, arising out of order dated 2-7-2005 passed in GTA Nos.2/Bang/2003 for the assessment year 1984-85 praying to (a) formulate the substantial questions of law stated therein, (b) allow the appeal and set aside the order passed by the ITAT in GTA No.2/Bang/2003 dated 02-07-2005 and confirm the order passed by the Appellate Commissioner confirming the order passed by the Deputy Commissioner of Income Tax, Bangalore, in the interest of justice and equity.

In G.T.A. No. 4 of 2005

BETWEEN:

1 The Commissioner of
Income Tax
C R Building
Queens Road
Bangalore – 560 001

2 The Deputy Commissioner
of Income Tax
Bangalore ...Appellants

(By Sri M V Seshachala, Advocate)

AND:

Sri N. Dayanand Reddy
No.337, 18th Cross
Sadashivanagar
Bangalore -80 ...Respondent

(By Sri A. Shankar, Advocate)

This GTA filed under Section 26 of the GTA Act 1958 & 27A of the Wealth Tax Act 1957, arising out of order dated 2-7-2005 passed in GTA Nos.1/Bang/2003 for the assessment year 1994-95 praying to (a) formulate the substantial questions of law stated therein. (b) allow the appeal and set aside the order passed by the ITAT in GTA No.1/Bang/2003 dated 02-07-2005 and confirm the order passed by the Appellate Commissioner confirming the order passed by the Deputy

Commissioner of Income Tax, Bangalore, in the interest of justice and equity.

In G.T.A. No. 5 of 2005

BETWEEN:

1 The Commissioner of
Income Tax
C R Building
Queens Road
Bangalore – 560 001

2 The Gift Tax Officer
Ward-2(1)
C R Building
Queens Road
Bangalore ...Appellants

(By Sri M V Seshachala, Advocate)

AND:

Smt. Shamalamma N
No.292, 9th Cross
ATH Layout
Shantinagar
Bangalore ...Respondent

(By Sri A. Shankar, Advocate)

This GTA filed under Section 26 of the GTA Act 1958 & 27A of the Wealth Tax Act 1957, arising out of order dated

12-7-2005 passed in GTA Nos.5/Bang/2003 for the assessment year 1994-95 praying to (a) formulate the substantial questions of law stated therein. (b) allow the appeal and set aside the order passed by the ITAT in GTA No.5/Bang/2003 dated 12-07-2005 and confirm the order passed by the Appellate Commissioner confirming the order passed by the Gift Tax Officer, Ward-2(1), Bangalore, in the interest of justice and equity.

These GTAs coming on for hearing this day, ***N. KUMAR J*** delivered the following :

JUDGMENT

As the same question of law is involved in all these three appeals, they are taken up for consideration together and disposed of by this common order. The revenue has filed these appeals challenging the common order of the tribunal.

2. The respondents in all these three appeals are assessees. They entered into a partnership with nine others in the name and style of M/s Amalgamated Property Developers. Partnership came to be constituted on 01.04.1993. Each of the assessees contributed the land owned by them into the partnership firm as their contribution. After five months, i.e.,

on 31.08.1993 all the three assessees retired from the firm receiving certain amounts as their share in the interest of the firm. The particulars of the book value of each of the assessees and the amount received by them at the time of retirement are as under:

Name of the Assessee	**Book Value** Rs.	**Amount Received At retirement** Rs.	**Difference amount** Rs.
Smt. Jayalakshmamma	11,69,375	22,35,375	11,25,000
N. Dayanad Reddy	28,26,250	69,59,250	41,33,000
Smt. Shamallamma	18,68,125	33,60,125	14,92,000

3. The Assessing Officer proceeded to hold that the assessees have adopted a device in order to avoid tax. The difference in the aforesaid amount is the deemed gift and therefore it falls under Section 4(1) of the Gift Tax Act (hereinafter, referred to as the 'Act') and accordingly he levied gift tax on the said deemed gift. Aggrieved by this order, all the

three assessees preferred an appeal to the Commissioner of gift tax. The appellate authority dismissed the appeal by affirming the assessment orders. Against the said order, the assessees preferred an appeal to the Tribunal. The Tribunal relying on the judgment of this Court in the case of ***N. PRASANNA Vs. COMMISSIONER OF GIFT TAX*** reported in ***ITR (228) 1997 pg. 427,*** held that the partners introduced immovable property by way of land as capital contribution to the firm and that the said transaction is bonafide and though there is transfer within the meaning of Section 2(xxiv) of the Gift Tax Act, no gift tax is leviable thereof. Therefore, it allowed the appeal by setting aside the order passed by the authorities below and granted relief to the assessees. Aggrieved by the said order of the Tribunal, the revenue has preferred these three appeals.

4. At the time of admission, this Court framed the following substantial questions of law:

In GTA No.3 of 2005

1. Whether the Tribunal was correct in holding that capital contribution of Rs.11,59,375/- by the assessee in favour of the partnership firm on 1-4-1993 and subsequent retirement on 31-8-1993 after four months by receiving a sum of Rs.22,84,375/- the difference of Rs.11,25,000/- cannot be treated as deemed gift as per the provisions of the Gift Tax Act?

2. Whether the Tribunal have recorded a finding that the capital contribution of Rs.11,59,375/- by the assessee in favour of the partnership firm on 1-4-1993 and subsequent retirement on 31-8-1993 after four months by receiving a sum of Rs.22,84,375/- amounts to a device adopted by the assessee in order to avoid tax?

3. Whether the Tribunal was correct in failing to record a finding that the entire transaction was bonafide not for inadequate consideration and consequently does not attract gift tax liability without passing a speaking order?

In GTA No.4 of 2005

1. Whether the Tribunal was correct in holding that capital contribution of Rs.28,26,250/- by the assessee in favour of the partnership firm on 1-4-1993 and subsequent retirement on 31-8-1993 after four months by receiving a sum of Rs.69,59,250/- the difference of Rs.41,33,000/- cannot be treated as deemed gift as per the provisions of the Gift Tax Act?

2 Whether the Tribunal have recorded a finding that the capital contribution of Rs.28,26,250/- by the assessee in favour of the partnership firm on 1-4-1993 and subsequent retirement on 31-8-1993 after four months by receiving a sum of Rs.69,59,250/- amounts to a device adopted by the assessee in order to avoid tax?

3 Whether the Tribunal was correct in failing to record a finding that the entire transaction was bonafide not for inadequate consideration and consequently does not attract gift tax liability without passing a speaking order?

In GTA No.5 of 2005

1. Whether the Tribunal was correct in holding that there was no gift despite the assessee having entered into a partnership by contributing property worth Rs.18,68,125/- and retiring after 4 moths by receiving a sum of Rs.33,30,544/- which would amount to a deemed gift.

2 Whether the Tribunal should have taken into consideration the finding recorded by the Appellate Commissioner which clearly showed that if the market value of the property was taken into consideration the deemed gift of Rs.34,69,375/- was liable to tax as held by the Appellate Commissioner.

3 Whether the Tribunal should have independently considered the facts and circumstances of assessee's case and recorded a categorical finding instead of clubbing this matter with other cases.

5. Though, three substantial questions of law are framed, in substance, the substantial question of law involved in this appeal is: as under:-

" Whether in a case of an assessee contributing his immovable property to a partnership firm towards his contribution, receives at the time of retirement from the partnership firm, consideration in excess of book value mentioned at the time of contributing the assets to the partnership firm, the difference in amount could be deemed to be deemed gift under Section 4(1)(a) of the Gift Tax Act ?"

6. The word 'Gift' has been defined under Section 2(xii) of the Act as under:

" 2(xii) – "gift" means the transfer by one person to another of any existing movable or immovable property made voluntarily and without consideration in money or money's worth and [includes the transfer or conversion of any property referred to in Section 4, deemed to be a gift under that section.]

The word 'transfer of property' is also defined at Section 2(xxiv) of the Act as under:

"2(xxiv) – "transfer of property" means any disposition, conveyance assignment, settlement, delivery, payment or other alienation of property and, without limiting the generality of the foregoing includes-

(a) the creation of a trust in property;

(b) the grant or creation of any lease, mortgage, charge, easement licence, power, partnership or interest in property.

(c) xxxxxxxxxx
(d) xxxxxxxxxx"

The words 'firm', 'partner' and 'partnership' is defined under Section 2(xi) of the Act as under:

" the expressions 'firm', 'partner' and 'partnership' shall have the meanings respectively assigned to them under section 2 of the Income tax Act."

7. Section 3 is the charging Section. It provides that subject to the other provisions contained in this Act, there shall

be charged for every assessment year commencing on and from the 1st day of April, 1958 [but before the 1st day of April 1987,] a tax (hereinafter referred to as gift-tax) in respect of the gifts, if any, made by a person during the previous year (other than gifts made before the 1st day of April, 1957), at the rate or rates specified in [Schedule I]. Sub-section (2) provides that subject to the other provisions contained in this Act], there shall be charged for every assessment year commencing on and from the 1st day of April, 1987, gift-tax in respect of the gifts, if any, made by a person during the previous year, at the rate of thirty per cent on the value of all taxable gifts.

8. Section 4(1)(a) which calls for interpretation in this case reads as under:

Gifts to include certain transfers:

(1) For the purpose of this Act,-

(a) where property is transferred otherwise than for adequate consideration, the amount by which the (value of the property as on the date of the transfer and determined in the manner laid

down in Schedule II.] exceeds the value of the consideration shall be deemed to be a gift made by the transferor."

9. Therefore for application of Section 4(1)(a), the pre-requisite is that there should be a transfer for consideration. If that consideration is inadequate, the difference in that value of property is deemed to be deemed gift under Section 4(1)(a) of the Act and gift tax is leviable under Section 3 of the Act. In this regard it is useful to refer to two judgments dealing with transfer of immovable property by a person to a partnership firm and consequence flowing therefrom. The Apex Court in the case of ***SUNIL SIDDHARTHBHAI Vs. COMMISSIONER OF INCOME TAX*** reported in ***1985 (156) ITR 509 SC,*** has held as under:

" .....when a partner brings in his personal asset into a partnership firm as his contribution to its capital, an asset which originally was subject to the entire ownership of the partner becomes now

subject to the rights of other partners in it. It is not an interest which can be evaluated immediately, it is an interest which is subject to the operation of future transactions of the partnership, and it may diminish in value depending on accumulating liabilities and losses with a fall in the prosperity of the partnership firm. The evaluation of a partner's interest takes place only when there is a dissolution of the firm or upon his retirement, from it. It has some times been said, and we think erroneously, that the right of a partner to a share in the assets of the partnership firm arises upon dissolution of the firm or upon the partner retiring from the firm. We think it necessary to state that what is envisaged here is merely the right to realise the interest and receive its value. What is realised is the interest which the partner enjoys in the assets during the subsistence of the partnership firm by virtue of his status as a partner and in accordance with the terms of the partnership agreement. It is because that interest exists already before dissolution, as was held by this Court in Malabar Fisheries Co. (supra), that the distribution of the assets on dissolution does not amount to a transfer to the erstwhile partners.

What the partner gets upon dissolution or upon retirement is the realisation of a pre-existing right or interest. It is nothing strange in the law that a right or interest should exist in praesenti but its realisation or exercise should be postponed. Therefore, what was the exclusive interest of a partner in his personal asset is, upon its introduction into the partnership firm as his share to the partnership capital, transformed into a shared interest with the other partners in that asset. Qua that asset, there is a shared interest. During the subsistence of the partnership the value of the interest at each partnership qua that asset cannot be isolated or carved out from the value of the partner's interest in the totality of the partnership assets. And in regard to the latter, the value will be represented by his share in the net assets on the dissolution of the firm or upon the partner's retirement."

"The consideration for the transfer of the personal assets is the right which arises or accrues to the partner during the subsistence of the partnership to get his share of the profits from time

to time and, after the dissolution of the partnership or with his retirement from the partnership, to get the value of a share in the net partnership assets as on the date of the dissolution or retirement after deduction of liabilities and prior charges. The credit entry made in the partner's capital account in the books of the partnership firm does not represent the true value of the consideration. It is a notional value only, intended to be taken into account at the time of determining the value of the partner's share in the net partnership assets on the date of dissolution or on his retirement, a share which will depend upon deduction of the liabilities and prior charges existing on the date of dissolution or retirement. It is not possible to predicate beforehand what will be the position in terms of monetary value of a partner's share on that date. At the time when a partner transfers his personal asset to the partnership firm, there can be no reckoning of the liabilities and losses which the firm may suffer in the years to come. All that lies within the womb of the future. It is impossible to conceive of evaluating the consideration acquired by the partner when the brings his personal asset into the partnership firm when neither the date of

dissolution or retirement can be envisaged nor can there be any ascertainment of liabilities and prior charges which may not have even arisen yet."

" What is the profit or gain which can be said to accrue or arise to the assessee when he makes over his personal asset to the partnership firm as his contribution to its capital? The consideration, as we have observed, is the right of a partner during the subsistence of the partnership to get his share of profits from time to time and after the dissolution of the partnership or with his retirement from the partnership to receive the value of the share in the net partnership assets as on the date of dissolution or retirement after deduction of liabilities and prior charges. When his personal asset merges into the capital of the partnership firm a corresponding credit entry is made in the partner's capital account in the books of the partnership firm, but that entry is made merely for the purpose of adjusting the rights of the partners interse when the partnership is dissolved or the partner retires. It evidences no debt due by the firm to the partner. Indeed, the capital represented by

the notional entry to the credit of the partner's account may be completely wiped out by losses which may be subsequently incurred by the firm, even in the very accounting year in which the capital account is credited. Having regard to the nature and quality of the consideration which the partner may be said to acquire on introducing his personal asset into the partnership firm as his contribution to its capital, it cannot be said that any income or gain arises or accrues to the assessee in the true commercial sense which a businessman would understand as real income or gain."

10. Following this judgment, a Division Bench of this Court in the case of ***N. PRASANNA Vs. COMMISSIONER OF GIFT TAX*** reported in ***ITR (228) 1997 pg. 427*** held as under:

" It is no doubt true that "consideration" for transfer, which is very relevant to determine capital gains, has normally no relevance to a gift, which in the generally accepted sense is a transfer without consideration. But, we are concerned here not with a "gift" which is a transfer without consideration, but with a "deemed gift" created by a legal fiction

under section 4(1)(a) of the Act. The transaction is not sought to be taxed as a transfer without consideration, but as a deemed gift arising under section 4(1)(a). To determine the extent of deemed gift, contemplated under section 4(1)(a), consideration is the relevant factor, as a deemed gift under the said provision arises where the property is transferred otherwise than for adequate consideration, that is for inadequate consideration. When the question relates to the extent or a adequacy of consideration for the transfer arising from a transaction where a partner contributes his individual property to the partnership, the decision in Sunil Siddarthbhai's case[1985] 156 ITR 509 (SC), which holds that the consideration for such a transfer is unascertainable until the dissolution of the partnership, becomes relevant and applicable. The principles laid down relating to consideration in the said decision with reference to transfer of an asset by a partner to the firm, as a capital contribution apply with equal force in this case."

".....it is impermissible to treat the amount entered as the value of the capital asset in the books of account of the firm, as the consideration

for the transfer for purposes of Section 4(1) of the Act."

".....though a contribution by a partner of his individual property towards the capital of the firm, amounts to 'transfer of property' for the purpose of the Gift Tax Act, there cannot be a deemed gift in such a case for the purpose of gift-tax, as it is not possible to determine the 'adequacy' of consideration."

11. A Division Bench of the Rajasthan High Court dealing with an identical issue in the case of ***COMMISSIONER OF INCOME-TAX Vs. MAURDHAR HOTEL (P.) LTD.,*** reported in ***ITR (269) 2004 Pg.310,*** interpreting Section 4(1)(a) has held as under:

"The requirements of Section 4(1)(a) are firstly, that there should be a transfer of property; secondly, the transfer should be for consideration; and thirdly, the consideration should not be adequate. In such a case the market value of the property so transferred at the date of transfer must be in excess of the consideration at which it has been purported to be transferred. In such an event,

the difference is to be considered as deemed gift by the transferor to the transferee."

"Ordinarily no element of consideration is involved in the case of transfer inter vivos by way of gift. With the insertion of Section 4(1)(a) some transfers with consideration also were deemed to be transfer amounting to deemed gift. Such deeming provisions were made applicable to transfers which were made otherwise than for adequate consideration and brought within the province of gift to be subjected to levy of gift tax."

"...bringing any asset as a contribution to the partnership capital by a partner amounts to reduction of his exclusive right to enjoy the asset during the subsistence of partnership and it becomes subservient to get his share in profits and losses so long as his status as a partner continues and upon dissolution of the firm or retirement from partnership to claim his share in partnership assets in accordance with the Partnership Act and agreement of partnership after satisfying the

liabilities of the firm and as a part of taking accounts".

"This brings to the fore, the question: What is the interest transferred and what is the consideration for which the transferor (the partner who contributes the asset) has transferred the asset? In the answer to it, lies the key to whether adequacy or inadequacy of consideration is determinable in praesenti at the time of contribution.

When an asset is brought as a contribution to the partnership capital in the firm, whether it is a transfer of full right in the property upon such transfer to be enjoyed by other partners or it is the right lesser than the full right in the asset? Upon transfer of interest in such property, right to be enjoyed jointly comes into existence, but it cannot be equated with the transfer of whole property in absolute inasmuch the contributor retains right to enjoy the property at best jointly as much as other partners also retain right to share partnership property including the one brought in by him on dissolution of the firm or on his retirement.

The aforesaid principle clearly indicates that bringing in of assets by a partner as his capital contribution to the firm is not a transfer of asset in wholesome value, but such transfer brings into existence a right which arises or accrues to the contributory partner, namely, during the subsistence of the partnership to get his share in profit or loss of the firm from time to time and after dissolution of the partnership or with his retirement from the partnership, to get the value of his share in the net partnership assets as on the date of dissolution or retirement after deduction of liabilities and prior charges as per law relating thereto. That is the right, that a partner gets in consideration. This is a continuous process and exact benefit or loss arising from admittance to the partnership, and its present value on the date of admittance to the firm is not determinable.

12. What follows from the aforesaid judgments is that when a partner brings in his asset into a partnership firm by way of contribution it amounts to transfer of property as

defined under the Gift Tax Act. Though it amounts to transfer of property, as a consideration for that transfer, he becomes entitled to the profits in the partnership firm. It is not a case of complete divesting of his interest in the property brought in as capital asset. Partially, the property is transferred and as a partner he continues to have interest in the said partnership asset. Not only he continues to have interest in the property brought by him to the partnership firm as a partner but if there are other partners who have brought in similar properties into the firm by way of asset, he will also have an interest in those properties. If at the time of constitution of partnership or at the time of his entry into the partnership, if a value is mentioned in the books of the partnership firm representing the interest he has brought into the partnership, it does not truly reflect the market value of the property which he has brought into the partnership firm. It is purely a notional value. The said notional value is only for the purpose of distributing the profits of the said partnership firm either at the time of dissolution or at the time of retirement. When a partner brings

his property into the partnership firm, though the consideration is that he will acquire the status of a partner and he continues to have interest in the partnership assets, there is no monetary consideration for such transfer of the property and the book value mentioned is not the consideration for such transfer. Section 4(1)(a) is attracted only in a case where there is a monetary consideration for transfer and that monetary consideration is lesser than the market value of the property, the difference in the amount being treated as a deemed gift under Section 4(1)(a). The share to which a partner is entitled to at the time of dissolution or retirement has no bearing on the question regarding the value of the property which he would have brought into the partnership at its inception. In that view of the matter, when there is transfer of property into a firm there is no consideration and the book value mentioned is a notional value. The share to which a partner is entitled to at the time of retirement from or dissolution of a partnership firm depends upon various other factors. The quantification of a partner's share cannot by any stretch of imagination be taken

into consideration to hold that there is inadequacy of consideration at the time of the partner bringing in the property into the partnership firm. On that basis it cannot be held the difference in the consideration constitutes a consideration for the deemed gift.

13. In the instant case all the three assesses brought their landed properties into the partnership firm. The transaction is not a sham transaction. In the books of account the value of the property is mentioned. It does not reflect the actual value of the properties, in other words, the market value of the properties. It is not a case of complete transfer of right of property in favour of the partnership firm. Partnership has admittedly not paid any consideration for such transfer when the properties were brought into the firm. When the partnership firm has not paid any consideration, when the amount mentioned in the books of accounts is only a notional value and when the partners even after transfer continues to have interest in the property and only on dissolution or

retirement, the actual share of a partner could be ascertained and the value of the property is unascertainable on the day they were brought into the partnership firm, the question of holding it as a deemed gift under Section 4(1)(a) is impermissible. That is precisely what the Tribunal has held on considering the various judgments on the point. In that view of the matter, we do not see any merit in the contention of the revenue. Accordingly, all the three appeals are dismissed and the substantial question of law is answered against the revenue and in favour of the assessees. No costs.

Sd/-
JUDGE

Sd/-
JUDGE

ksp/-