A M/S. KHODAY ESWARSA AND SONS

v.

THE COMMISSIONER OF GIFT TAX

OCTOBER 16, 2001

B [S.P. BHARUCHA, Y.K. SABHARWAL AND BRIJESH KUMAR, JJ.]

Gift Tax Act, 1958 : Section 6(2).

Gift Tax—AY 1970-71—Gifted property—Revocability of—Capitalized value—Assessee granted licence to a private company for five years subject to its termination with six months' notice—Gift Tax Officer treated it as a gift and levied gift tax—Validity of—Held : Revocability of the gift is the relevant fact—It is immaterial whether it was, in fact, revoked or not—In the instant case, gift is revocable/terminable with six months' notice—It is not revocable for a specified period which is less than a year—Therefore, the capitalized value under R. 11(1) is 'nil'—Hence, no gift tax is payable—Gift Tax Rules, R. 11(1).

The appellant-assessee, a partnership firm, was carrying on various businesses. The partnership firm consisted of seven partners. Four partners retired from the firm, which was reconstituted by the remaining partners. The newly constituted firm entered into an agreement with a private limited company. Under the said agreement the appellant-assessee granted licence and persmission to the private limited company as a licensee to carry on and conduct the business of manufacturing certain products. The period of licence provided in the agreement was five years subject, however, to the termination by either party, giving to the other, six months' notice in writing. As a consideration for the agreement, the licensee agreed to pay a certain minimum fee or compensation.

The Gift Tax Officer treated the transfer of business by the firm to the private limited company as a gift under the Gift Tax Act, 1958 made for inadequate consideration and levied the gift tax for the Assessment Year 1970-71 on the value of the deemed gift. However, the Appellate Authority held that the deemed gift made by the assessee under the agreement was exempt under Section 5(1)(xiv) of the Act. But the Income Tax Appellate Tribunal reversed the order of the Appellate Authority. The High Court answered the reference under Section 26(1) of the Act against

the appellant-assessee. Hence this appeal.

On behalf of the appellant it was contended that no gift tax was payable as the case squarely fell within the ambit of Section 6(2) of the Act read with Rule 11 of the Gift Tax Rules.

Allowing the appeals, the Court

HELD : 1. The language of Rule 11(1) of the Gift Tax Rules is clear. It does not admit of any two interpretations. The relevant factor is the revocability of the gift and not whether, in fact, it was revoked or not within the period of five years. Under Rule 11(1) what is of relevance is "the number of compete years.....for which the gift is not revocable...". In the present case, the gift was revocable/terminable with six months' notice. Thus, it was not revocable for a specified period, which was less than a year, namely, six months. The capitalized value has to be fixed under Rule 11(1) under which if it was revocable for a period less than one year, the value could not be worked out and, thus, it had to be 'nil'. [183-F-G]

CIVIL APPELLATE JURISDICTION : Civil Appeal Nos. 2751-2752 of 1998.

From the Judgment and Order dated 16.3.90 of the Karnataka High Court in T.R.C. Nos. 66 and 67 of 1982.

G. Sarangan, P.R. Ramasesh and Abhay Prakash Sahay for the Appellant.

M.L. Verma, Ms. Neera Gupta, B.V. Balaram Das for Ms. Sushma Suri for the Respondent.

The Judgment of the Court was delivered by

Y.K. SABHARWAL, J. At the instance of the assessee, three questions that were referred to the High Court for its opinion under Section 26(1) of the Gift Tax Act, 1958 are as under :

1. "Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that there was a deemed gift taxable under the Gift Tax Act, 1958 for assessment year 1970-71 in respect of arrangement in pursuance of agreement dated 21.11.1969 between the assessee and M/s. Khoday Industries

A Pvt. Ltd.?

2. Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that a partnership firm is an assessable entity under the provisions of Gift-Tax Act, 1958?

B 3. Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the gift, if any, in the arrangement was not exempt under the provisions of Sec. 5(1)(xiv) of the Act?"

C The High Court having answered the questions against the assessee, these appeals have been preferred by the assessee. The appellant has not pressed question Nos. 2 and 3. The only question that is required to be examined is the first question.

The appellant, a partnership firm, was carrying on various businesses. D The partnership firm consisted of seven partners. On 20th November, 1969, four partners retired from the firm which was reconstituted by the remaining partners by taking into reconstituted firm, the children of the outgoing partners. On 21st November, 1969, the newly constituted firm entered into an agreement with a private limited company floated by the four outgoing partners. E Under the said agreement, the firm granted licence and permission to the private limited company as a licensee to carry on and conduct the business of manufacturing Indian-made liquors, carbon-papers, typewriting-ribbons etc. and for running the business handed over the premises, buildings, plants, machineries and all other equipments which were being used by the firm for F the said businesses. The period of licence provided in the agreement was five years subject, however, to the termination by either party, giving to the other six months notice in writing. As a consideration for the agreement, the licensee agreed to pay a minimum fee or compensation of Rs. 50,000 per month and maximum of Rs. 60,000 per month.

G The Gift-Tax Officer treated the transfer of business by the firm to the private limited company as a gift under the Gift Tax Act made for inadequate consideration and levied the gift tax on the value of the deemed gift which was computed at Rs. 1,10,25000. On the appeal preferred by the assessee, the Appellate Authority held that the deemed gift made by the assessee under the H agreement dated 21st November, 1969 was exempt under Section5(1)(xiv) of

the Act on the ground that the gift made was for the purpose of business of the donor. A

On the appeal of the Revenue, the Income Tax Appellate Tribunal, reversing the order of the Commissioner of Income Tax (Appeals), held that the agreement amounted to transfer of property; the consideration was not adequate with the result that there was a deemed gift within the meaning of Section 4(1)(a) of the Gift Tax Act and that the transaction was not *bona fide.* Therefore, the Tribunal held that Section 5(1)(xiv) which, *inter alia,* provides that the gift tax shall not be charged in respect of gifts made by any person in the course of carrying on a business to the extent to which the gift is proved to the satisfaction of the Gift-Tax Officer to have been made *bona fide* for the purpose of such business, is not applicable. B C

The aforestated questions were answered by the High Court against the appellant. D

Learned counsel for the appellant contends that the transaction under the agreement dated 21st November, 1969 was a commercial transaction whereby licence was granted by the appellant to the private limited company for running of the business by the said company for a period of five years and both the Tribunal and the High Court fell into an error in coming to the conclusion that the transfer of business under the agreement was a 'gift'. The Tribunal, on appreciation of the facts, has recorded a finding of fact that the consideration was less than half the value of the property. On this finding, the Tribunal concluded that to the transaction the provisions of Section 4(1)(a) are clearly attracted. Section 4(1)(a), *inter alia,* stipulates that where property is transferred otherwise than for adequate consideration, the amount by which the market value of the property at the date of the transfer exceeds the value of the consideration shall be deemed to be a gift made by the transferor. The Tribunal has held that the property has been transferred for inadequate consideration inasmuch as the consideration stipulated in the agreement was less than half the value of the property. The appellant did not bring on record any special circumstances which may justify such a reduced consideration. The conclusion drawn by the Tribunal and affirmed by the High Court that the transaction was not *bona fide* and the property was transferred otherwise than by adequate consideration is very possible conclusion on the facts found. In this view we are unable to accept the contention that it was a commercial E F G H

A transaction and not a gift.

Learned counsel next contends that assuming that it was a gift, then too no gift tax is payable as the case squarely falls within the ambit of Section 6(2) of the Gift Tax Act read with Rule 11 of the Gift Tax Rules. The contention is that it is a gift which is not revocable for a specified period and
B the capitalized value can be worked out only under Rule 11. Under that rule, the contention further is, the minimum period for computing the value of the gift is one year and here the gift being revocable with six months notice, the valuation has to be nil.

C The termination has been provided for in clause (3) of the agreement. The said clause reads as under :

> "The period of the licence and permission shall be five years commencing from the 21st day of November, 1969. However, this agreement may be terminated by either party giving to the other party at
D least six calender months notice in writing."

The licence deemed to be a gift, is not revocable for a specified period, namely, six months.

E Section 6 provides for determination of valuation of gifts. It is nobody's case that sub-section (1) or (3) of Section 6 has any applicability to the present case. Sub-section (2) of Section 6 which is relevant here for determination of the value of the gift reads as under :

> "6(2) Where a person makes a gift which is not revocable for a
F specified period the value of the property gifted shall be the capitalized value of the income from the property gifted during the period for which the gift is not revocable."

Rule 11(1) may also be extracted. It reads as under :

G "11(1) In the case of property referred in sub-section (2) of Section 6 of the Act, the capitalized value of the income shall be taken to the product of the number of complete years included in the period for which the gift is not revocable and the average of the income received from the property during the three years or such lesser period of
H complete years in which such property was in existence, preceding the

previous year for the year of assessment after discounting it at a rate of 4 per cent per annum : A

Provided that where the property was in existence for less than one complete year preceding the previous year for the year of assessment or came into existence in the previous year for the year of assessment, the income from such property for one complete year shall be the income which would have been receivable, if the property were in existence for one complete year." B

The Tribunal held that since Section 6(2) refers to revocable gifts for a specified period and in the present case, the licence was for a period of five years and, therefore, it has to be taken as a full period according to Rule 11. The Tribunal was of the opinion that "The fact that it is terminable at six months' notice is also not relevant". Further, the Tribunal took into consideration the fact that the agreement was not cancelled within the period of five years. The High Court affirmed the view of the Tribunal by holding that "Though the clause provided for revocation with six months' notice on either side, it was not acted upon. Therefore the Tribunal was right in upholding the levy of gift tax on the capitalized value of the gift, taking the gift as for five years". C D

The Tribunal as well as the High Court clearly fell into an error in upholding the levy of gift tax on the capitalized value of the gift taking the gift as for five years and treating as irrelevant the clause providing for termination at six months notice and also taking into consideration the fact that the argeement was not cancelled within the period of five years. In our view, that is of no consequence. The language of Rule 11(1) is clear. It does not admit of any no two interpretations. The relevant factor is the revocability of the gift and not whether, in fact, it was revoked or not within the period of five years. Under Rule 11(1) what is of relevance is "the number of complete years...for which the gift is not revocable....". In the present case, the gift was revocable/terminable with six months' notice. Thus, it was not revocable for a specified period which was less than a year, namely, six months. The capitalized value has to be fixed under Rule 11(1) under which if it was revocable for a period less than one year, the value could not be worked out and, thus, it had to be 'nil'. E F G

The Tribunal as well as the High Court were in error in rejecting the H

A assessee's contention that in terms of Rule 11(1), no gift tax was payable. Admittedly, there is no other provision under which the capitalized value could be fixed.

In the aforesaid premises, we allow the appeals and set aside the judgment and order of the High Court, in regard to the first question aforestated. Accordingly we answer that question in the negative and in favour of the assessee. Parties are left to bear their own costs.

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V.S.S. Appeals allowed.