

Commissioner of Income-tax, Gujarat v. M/s. B. M. Kharwar

Civil Appeal No. 1678 of 1966

[1969] 1 SCR 651 | 1968-08-13

Historical machinery balancing charge on conversion from firm to company: tax followed the transaction's true legal effect, not a supposed business-substance equivalence, but former section 10(2)(vii) applied only to a sale, requiring a further Tribunal finding whether the consideration structure was sale or exchange.

Indian Income-tax Act, 1922: section 10(2)(vii), second proviso, as amended by Act 67 of 1949 | Indian Income-tax Act, 1922: section 66(5)

3-judge bench; unanimous judgment delivered by J. C. Shah, J. | J. C. Shah, J. | V. Ramaswami, J. | A. N. Grover, J.

Assessment years: 1959-60

Sale finding remained open

Although the firm and company were distinct legal entities, former section 10(2)(vii) applied only if machinery was sold. The Tribunal had made no clear sale finding, so the Supreme Court declined to answer the taxability question finally.

Sale and exchange distinguished

A transfer solely for allotted shares could be exchange; a money-price obligation satisfied by shares could comprise a sale plus a separate satisfaction arrangement. The actual consideration terms were essential.

Realisation-sale argument narrowed by 1949 amendment

After insertion of the words covering a sale during business or after cessation, closure or winding-up did not itself prevent the excess over written-down value being taxed, subject to the statutory maximum and existence of a sale.

Do not universalise 'legal form' language

The Court allowed authorities to identify the true legal relation and unravel a concealed device. The judgment does not authorise ignoring evidence of fraud or applying its historical formulation without checking later legislation and doctrine.

01 FACTS OF THE CASE

The respondent firm manufactured, purchased and sold cloth. It closed the manufacturing side and transferred factory machinery to a private company whose share capital reflected the partners' existing interests in the firm's assets and profits. For assessment year 1959-60 the Income-tax Officer invoked section 10(2)(vii), second proviso, to tax Rs.40,743 as realisation above written-down value. The Tribunal treated the change as carrying on through a company rather than a firm and found no business profit; the Gujarat High Court answered the referred taxability question in the negative. Revenue appealed by certificate (SCR pp.652-653; PDF pp.2-3).

Source: [Primary judgment: facts](#)

02 DISCUSSION BY THE HON'BLE COURT

Tax liability had to follow the true legal relation created. The firm and company were distinct entities, and a transfer for consideration could not be treated as non-existent merely because partners received corresponding company interests. Authorities could unravel a concealed device, but they could not displace the legal effect of a genuine transaction by invoking an undefined 'substance' different from the parties' actual rights and liabilities (SCR pp.654-656; PDF pp.4-6). The 1949 amendment made the qualifying excess taxable whether sale occurred during business or after cessation, so a realisation or winding-up sale was not excluded for that reason alone (SCR pp.657-658; PDF pp.7-8). Yet section 10(2)(vii) still required a sale. Transfer for shares alone might be exchange, whereas a money-price obligation satisfied by shares could be sale plus discharge. Because the Tribunal had not made the needed finding, the reference could not be answered on the record (SCR pp.658-659; PDF pp.8-9).

Source: [Primary judgment: discussion](#)

03 JUDICIAL DECISION

The Court allowed Revenue's appeal, discharged the High Court's answer and permitted the Tribunal to rehear the parties under section 66(5) and record clear findings in light of the judgment. It did not finally decide whether the machinery transfer was a sale attracting the Rs.40,743 charge. There was no order as to costs in the Supreme Court or High Court (SCR p.659; PDF p.9).

Source: [Primary judgment: decision](#)

04 OUTCOME / IN WHOSE FAVOUR

Mixed outcome with limited procedural relief to Revenue. The legal bases adopted below were rejected and the reference reopened, but the assessee's ultimate tax liability remained dependent on the Tribunal's sale-versus-exchange finding (SCR pp.656-659; PDF pp.6-9).

Source: [Primary judgment: outcome](#)

05 AKHB REVIEW POINT

AKHB analysis: in an asset transfer on conversion or incorporation, document separately the transfer instrument, stated money price, share allotment, discharge mechanics, continuity of business and statutory year. Legal-entity continuity of ownership interests does not erase the transfer, but classification as sale, exchange or another arrangement turns on the actual consideration rights. Apply current depreciation, transfer and anti-avoidance provisions independently; this limited historical remand is not a final current-law taxability ruling (based on SCR pp.655-659; PDF pp.5-9).

Source: [Primary judgment: reviewPoint](#)

SOURCE & VERIFICATION

[Supreme Court Reports scan - public eSCR mirror](#)

Full 9-page SCR report read and checked. The editorial headnote and adjacent-report boundary text were distinguished from the judicial opinion and operative order.

[Open cited source rendition](#)

Exact source bytes, SHA-256 and 9-page count match catalogue asset 1969_1_651_659; every page was reviewed.

The source verifies Civil Appeal No. 1678 of 1966, the stated bench, issues, reasoning and operative result.

No published or archived standalone AKHB note with this source hash, case identity and operative decision was found.

STATUTORY SCOPE

The decision construes the balancing-charge language of section 10(2)(vii) of the repealed Indian Income-tax Act, 1922 after the 1949 amendment and before later statutory regimes. Its sale-versus-exchange analysis and strict-legal-effect reasoning must not be presented as current depreciation, transfer, capital-gains or anti-avoidance law. No current-law or later-treatment clearance was undertaken.

LATER TREATMENT

Source checked 2026-10-11. Later judicial treatment and current statutory applicability have not been comprehensively checked; no current-law or citator clearance is represented.

AI DISCLOSURE

This AKHB research note was prepared with AI assistance from the identified primary report and has not been represented as independently human-reviewed.

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