(2003) 11 MAD CK 0017

In the Madras High Court

Case No : Tax Case No''s. 357 to 360 of 1999

Commissioner of Gift-tax APPELLANT

Vs

S. Ashok and Others RESPONDENT

Date of Decision : 03-11-2003

Acts Referred:

Citation : (2004) 192 CTR 513 : (2004) 270 ITR 240

Hon'ble Judges : S.R. Singharavelu, J;R. Jayasimha Babu, J

Bench : Division Bench

Advocate : K. Subramaniam, for the Appellant; P.P.S. Janardhana Raja, for the Respondent

Judgement

R. Jayasimha Babu, J.—This reference is under the Gift-tax Act which has since been repealed.

2. A partnership firm, which originally consisted of five partners, was reconstituted on October 1, 1982, by admitting the company as a partner

and allotting to it a 60 per cent. share in the profits and losses after it brought in fresh capital of Rs. 30,000/-. The shares of the original five

partners were at the time of reconstitution reduced from 20 per cent. to 8 per cent. each. Subsequently, on December 31, 1982, the original five

partners retired, and received at the time of retirement their capital as shown in the books of account of the firm. The genuineness of the firm was

not questioned by the Revenue.

3. Four years later, in the year 1986, one of the properties which belonged to the firm the property being an immovable property in the State of

Kerala was sold by the company which had become the owner of all the assets of the erstwhile firm, for a sum of Rs. 27/- lakhs. The Assessing

Officer taking note of that fact proceeded to make assessments under the Gift-tax Act against the five original partners by treating the difference

between sixty per cent. of the market value of the property as on October 1, 1982, and the amount of capital brought in by the company as

constituting a gift in favour of the company. He also brought to gift-tax the difference between 40 per cent. of the market value of that property as

on December 31, 1982, and the amounts received by the erstwhile partners as constituting a gift to the company.

4. On appeal, the Commissioner held, and held rightly, that where the reduction in the value of the share of a partner is accompanied by the newly

admitted partner to whom a share corresponding to the reduction had been allotted, bringing in fresh capital equal to the amount by which the

capital of other partners was reduced, there was no gift. The Commissioner recorded a finding that the company which was admitted as a partner

on October 1, 1982, had brought in capital to the extent of Rs. 30,000/-, the exact amount by which the capital contribution of the original five

partners was reduced after the admission of the company as a partner. He held, therefore, that the admission of the company as a partner was for

a consideration and there was no gift or deemed gift as on October 1, 1982.

5. The Commissioner, however, upheld the order of the Assessing Officer who had sought to levy gift-tax on the difference between 40 per cent.

of the market value and the amount paid to the retiring partners/releasors after they had released their rights in the firm''s properties. While

concluding his order, he erroneously stated that the appeal was dismissed, while, in fact, the appeal should have been allowed in part.

6. On further appeal by the assessee to the Tribunal, the Tribunal held that no gift-tax was payable either on account of the admission of the

company as a partner or on account of the subsequent retirement of the original partners. The Tribunal took note of the fact that what was sold in

the year 1986 was only one of the assets that had belonged to the firm, that no effort had been made to ascertain the net value of the assets of the

firm as on the date the erstwhile partners retired, and more important that the firm had suffered losses continuously from the years 1979-80 to

1983-84 and, that the reason for admitting the company as a partner was to reduce the exposure of the original partners to the liabilities of the firm which continued to incur losses and that was also the reason why on a subsequent date they released their rights in the firm and allowed the company to take over all the assets and liabilities of the firm. It was held that the admission of the company as a partner, as also the subsequent release by the original partners were bona fide transactions.

7. The Tribunal has also pointed out that in terms of the agreement constituting the firm, if a partner wished to retire, he would only be entitled to his capital contribution. In accordance with that clause, the retiring partners were paid only their capital contribution and they had executed the release deed subsequently, only because one of the properties which was owned by the firm was an immovable property. The Tribunal further noticed the fact that the amount paid to the retiring partners was not an amount which was ascertained after taking note of all the assets and liabilities of the firm and, there was no material at all to hold that what was paid to the retiring partners was an amount which was less than the amount they would have been entitled to on taking into account all the assets and liabilities of the firm on the date of their retirement.

8. When a partnership is constituted, it is open to the partners to agree among themselves the terms subject to which they will carry on business as a firm. It is also open to them to agree on the terms on which they will agree to relinquish their interest in case any one of them decides to do so. So long as the terms of the agreement are not incompatible with any statutory requirement, the terms agreed among the partners are the terms that bind them. It was open to the partners in this case to agree that in the event of a partner wanting to retire, he would only be paid the amount standing to his capital amount in the books of the firm.

9. In case of dissolution of a firm, when all the assets and liabilities are valued and the entitlement of each of the partners determined in proportion to his share in the firm and any of those partners relinquish a part of their entitlement under the partnership deed, and agree to receive less, it can be said that there is a gift to the extent of that difference. But for coming to such a conclusion, it is first necessary that all the assets and liabilities of the firm should have been determined and the entitlement of each partner ascertained. It is not permissible to take the value of one property which had been sold and on that basis proceed to hold that there was a gift of the

difference in the market value of the property and the amount that had been

received by the individual partner at the time of retirement. As noticed by the Tribunal, in this case, the firm had suffered losses continuously and

the reason for admitting the company as a partner was to reduce the exposure of the original partners to further losses and further liabilities. It is

also that very reason that prompted them subsequently to release their rights in the firm and accept only the amount to their credit in the capital of

the firm.

10. The Supreme Court in the case of The Commissioner of Gift Tax, Trivandrum Vs. T.M. Louiz, considered a case where a partner had retired

from two firms. He was sought to be taxed under the Gift-tax Act on the ground that the amounts taken by him from the firms for his share was

less than the market value thereof, as the goodwill of the firm had not been taken into account. The court held that when a partner retires, all that he

gets is the value of his share in the firm''s assets less its liabilities and that, in such circumstances, it cannot be held, assuming that the retiring partner

received less than what was due to him, that the difference was something that he had transferred to the continuing partners within the meaning of

transfer of property"" for the purposes of the Gift-tax Act.

11. Though in this case the firm did not continue, as all the partners except the one in whose, favour the rights were relinquished had retired, the

principle laid down in that decision governs the case on hand as well, as there has been no ascertainment of the net value of the firm after taking

note of all the assets and liabilities. Merely taking note of the value of one property that had been owned by the firm and which was sold four years

after the assessee had relinquished his rights in the firm does not make the assessee liable for gift-tax, when as found by the Tribunal the reason for

relinquishment of the rights of the assessee in the firm was the fact that the firm continued to suffer losses and, on that account, the assessee did not

wish to continue in the firm any longer.

12. The two questions referred to us, viz., (1) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law

and had enough materials to hold that there was no gift or deemed gift involved in the transactions of admission of the company into the partnership

and retirement of the partners resulting in dissolution of the firm ? ; and (2)

Whether, on the facts and in the circumstances of the case, the

Appellate Tribunal was right in law in holding that clause 12 of the partnership deed came into operation to determine the rights of the retiring

partners ? are answered in favour of the assessee, and against the Revenue. The assessee is entitled to costs in the sum of Rs. 2,500/-.

