(1997) 11 MAD CK 0087

In the Madras High Court

Case No : TC No. 961 of 1985

Commissioner of Income Tax APPELLANT

Vs

A.C. Mahesh RESPONDENT

Date of Decision : 04-11-1997

Acts Referred:
Income Tax Act, 1961 — Section 2(47), 41(2), 45

Citation : (1999) 239 ITR 616

Hon'ble Judges : P. Thangavel, J;N.V. Balasubramanian, J

Bench : Division Bench

Advocate : C.V. Rajan, for the Appellant; R. Meenakshisundaram, for the Respondent

Judgement

N.V. Balasubramanian, J.—At the instance of the Department, the Tribunal has stated a case and referred the following question of law

under s. 256(1) of the IT Act, 1961, for our consideration.

Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that there can be no assessment of any excess

under the provisions of s. 41(2) and of capital gains?

2. At the outset, we must state that the referential s. 41(2) of the IT Act, 1961 in the question of law referred to us is not accurate. There was no

consideration of provisions of the applicability of s. 41(2) of the IT Act and there could not be applicability of the said provision to the facts of the

case. Therefore, the question of law referred to us is reframed as under :

Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that there can be no assessment of any excess

under the provisions of ""capital gains"" under the IT Act, 1961 ?

3. The assessee is an individual and in the accounting year relevant for the asst. yr. 1977-78, the assessee entered into a partnership agreement

with two private limited companies. The assessee brought into the business of the partnership buildings and lands valued at Rs. 30,000 and Rs.

1,50,000 respectively. The business of partnership was stated to be the real estate, letting out or hiring of the properties, construction of flats,

shops, houses etc. The partnership was to commence on 1st April, 1976 and the partnership was dissolved on 30th March, 1977 on account of

the fact that the business could not be carried on and no useful purpose would be served by continuing the partnership. The partnership assets

were allotted to the erstwhile partners. The ITO for the asst. yr. 1977-78, assessed a sum of Rs. 66,892 under the head ""capital gains"" by

deducting from the value of the land and building brought by the assessee to the partnership firm valued at Rs. 1,80,000. The ITO determined the

cost of land and building at Rs. 1,13,108 and brought to tax the sum of Rs. 66,892 as capital gains.

4. The assessee preferred an appeal before the CIT(A) and contended that no capital gain arose by allotment of immovable property to the two

limited companies on the dissolution of the firm as per the dissolution agreement. The CIT(A) held that the properties were allotted at the time of

dissolution of the firm and therefore, no capital gain arose and in that view of the matter, allowed the appeal preferred by the assessee.

5. The Revenue carried the matter in appeal before the Tribunal and it was contended on behalf of the Revenue that the CIT(A) failed to

appreciate that what the Revenue sought to tax was the capital gains arising from the assessee''s original contribution of immovable property as his

share of capital, and not the capital gains arising to the assessee on dissolution of the partnership deed. It was contended on behalf of the Revenue

that there was a transfer of the capital assets by the assessee to the firm and the immovable properties were transferred to the firm when the

partnership was formed. The Tribunal however placing reliance on the decision of this Court in the case of D. Kanniah Pillai Vs. Commissioner of

Income Tax, , held that there was no transfer of the capital assets when the assessee made over the capital assets to the firm as his contribution and

therefore, no liability under the capital gains arose in that transaction. The above order of the Tribunal is the subject-matter of this Tax Case

Reference and Mr. C.V. Rajan, learned counsel for the Revenue submitted that the view of the Tribunal is not sustainable in law in view of the later

decision of the Supreme Court in the case of Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat, and submitted that

there was a transfer of the capital assets when the assessee transferred the buildings and land to the partnership firm. He also submitted that the

decision of the Supreme Court would be applicable to the extent of the capital contribution of Rs. 5,000 by the assessee and so far as the amount

credited in the current account in favour of assessee a sum of Rs. 1,75,000 is concerned, there was a transfer of capital assets for consideration

and to this extent, the capital gains liability would be attracted.

6. Mr. R. Meenakshisundaram, learned counsel for the assessee, however, did not seriously dispute the position that there was transfer of the

capital asset when the assessee transferred the capital asset to the firm as his contribution. He also submitted that it is not possible to evaluate the

value of the consideration though the amount was credited in the current account of the firm.

7. We have carefully considered the rival submissions of learned counsel appearing for the parties. The Tribunal has decided the only question as

to whether there was a transfer of capital asset when the assessee made over the buildings and land to the firm as his contribution and in that view

of the matter the Tribunal has not decided any other point. The view of the Tribunal that there was no transfer is based on the decision of this Court

in D. Kanniah Pillai''s case (supra) and the Tribunal held that there was no transfer of (supra) the capital asset by the assessee when he contributed

the assets to the firm at the time of formation of the firm. This view of the Tribunal is not legally sustainable in view of the subsequent decision of the

Supreme Court in the case of Sunil Siddharthbhai cited supra, wherein the Supreme Court held that where a partner of a firm makes over capital

assets which are held by him to a firm as his contribution towards capital, there is a transfer of capital asset within the terms of s. 45 of the IT Act,

1961, because an exclusive interest of the partner in personal assets is reduced, on their entry into the firm, into a shared interest. Therefore we are

of the view that the Tribunal was not correct in holding that there was no transfer of the property when the partner introduced his capital asset as his capital contribution. The further question that remains is whether it is possible to evaluate the partner''s interest by the credit of certain amount in

the capital account as well as in the current account of the partners in the accounts of the firm. The Supreme Court in Sunil Siddharthbhai''s case

held that when the personal assets merge with the capital of the partnership and the corresponding credit entry is made in the partner''s capital

account in the books of the partnership firm, that entry is made merely for the purpose of adjusting the rights of the partners inter se when the

partnership is dissolved or when the partner retires. The question whether it is possible to reckon the partner''s interest when certain amount is

credited in the current account has not been gone into by the Tribunal and in the absence of any finding by the Tribunal, it is not possible for us to

answer that part of the question whether the capital gains liability would be attracted when amounts are credited both in the capital account and

current account of the accounts of the firm in favour of the partner who brought in his personal assets to the partnership firm as the property. Since

the Tribunal has not gone into the question whether it is possible to reckon the partner''s interest and whether any liability to capital gains would

arise, when certain amounts were credited in the current account of the partners and the nature of the current account, we direct the Tribunal to

decide the question in the light of the observations made by the Supreme Court in Sunil Siddharthbhai''s case cited supra and dispose of the appeal

accordingly. Subject to the above, the question of law referred to us is answered in the affirmative and in favour of the Revenue. However, as

earlier stated, the Tribunal is directed to go in to the question whether it is possible to reckon the interest of the assessee when the amounts are

credited both in the capital account as well as in the current account of the partnership firm and the liability to capital gains, if any, in the transaction

in question. No costs.