
(1982) 07 AP CK 0013

In the Andhra Pradesh High Court

Case No : Referred Case No. 28 of 1977

Commissioner of Income Tax

APPELLANT

Vs

L. Raghu Kumar

RESPONDENT

Date of Decision : 21-07-1982

Acts Referred:

Income Tax Act, 1961 — Section 2(14), 2(47), 256(1), 41(2), 45
Registration Act, 1908 — Section 17(1)(c), 48

Citation : (1982) 11 TAXMAN 163

Hon'ble Judges : K. Amareshari, J;B.P. Jeevan Reddy, J

Bench : Division Bench

Advocate : M. Suryanarayana Murthy, for the Appellant; Y.V. Anjaneyulu, for the Respondent

Judgement

K. Amareshari, J.—This reference u/s 256(1) of the income tax Act, 1961 ("the Act") at the instance of the revenue raises an interesting question of law as to the scope and ambit of section 45 of the Act relating to capital gains tax. The assessee is the karta of a HUF. He was previously a partner in two firms (1) Chegu Krishnamurthy, Guntur, and (2) Southern Tobacco Packers, Guntur. The assessee retired from the above two firms with effect from 1-1-1971. On the date of retirement, his capital accounts were credited with a sum of Rs. 46,500 more than the amount due to him towards his capital and profits. The firms from which the assessee retired were carrying on their business with the remaining partners. The ITO observed that the amount of Rs. 46,500 received by the assessee from these two firms was to be treated as capital gains in the hands of the assessee. Accordingly, the ITO assessed the capital gains in the hands of the assessee. The main contention that the case is governed by section 47(ii) of the Act and the transaction cannot be regarded as a transfer so as to attract the liability u/s 45, was rejected by the ITO on the ground that it was not a case of dissolution of the firm. The matter was carried in appeal. The assessee reiterated the same contention, namely, that the sum of Rs. 46,500 could not be treated as capital gains in view of section 47(ii). The AAC negated the contention of the

assessee and upheld the order of the ITO.

2. The assessee went up in a further appeal to the Appellate Tribunal. Before the Tribunal there was a shift in the stand and the assessee contended that there was no transfer of any "capital asset" within the meaning of section 2 (47) of the Act. It was urged that a partner has no right to the partnership assets as such and his right is only to receive a share in the profits and assets when he retires from the firm. In support of his contention, the assessee relied upon a decision of the Gujarat High Court in Commissioner of Income Tax, Gujarat Vs. Mohanbhai Pamabhai, The Tribunal accepted the contention based on the principle enunciated in the Gujarat High Court case and allowed the appeal.

3. On application by the revenue, the following question was referred to us for our decision:

"Whether, on the facts and in the circumstances of the case, the excess amount of Rs. 46,500 received by the assessee on retirement from the two partnership firms is assessable to capital gains?"

4. To answer this question, it is necessary to refer to a few relevant sections of the Act. Section 45, the charging section, is as follows:

"45(1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 53, 54, 54B, 54D and 54E be chargeable to income tax under the head "Capital gains", and shall be deemed to be the income of the previous year in which the transfer took place."

5. Section 2 (14) defines "capital asset" as under:

" (14) "capital asset" means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include-

6. Section 2 (47) defines "transfer" as follows:

" (47) "transfer", in relation to a capital asset, includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law;"

7. Section 47 exempts certain transfers from the provisions of section 45. Section 47(ii) is as follows:

" (ii) any distribution of capital assets on the dissolution of a firm, body of individuals or other association of persons;"

8. It is admitted that the instant case is not governed by section 47(ii) as there was no dissolution of the firm. The ITO as well as the AAC on facts found that the firm was continuing with the remaining members. In fact the assessee gave up the plea based on section 47(ii), even before the Tribunal.

9. Mr. Suryanarayana Murthy, the learned counsel for the revenue mainly

contended that on retirement of a partner from the firm, a transfer, within the extended meaning given in section 2(47) is involved. There is a relinquishment of the interest of the partner in the partnership assets and an extinguishment of his rights in the partnership assets. He submits that a distinction has to be drawn between a case of retirement of a member and dissolution of the firm. He says that in the case of the former, the retiring partner relinquishes his rights in the partnership assets resulting in extinguishment of his rights in the existing partnership, whereas in the case of a dissolution of the firm, the position is different as the partnership itself comes to an end.

10. On the other hand, it is contended by Mr. Anjaneyulu, the learned counsel for the assessee, that in law there is no distinction between the two, as a partner has no right to the partnership assets so as to involve a transfer either on retirement or dissolution. There is neither relinquishment of any asset nor extinguishment of any right to the asset. The retiring partner walks out with the amounts due to him towards his share of profits and assets.

11. To decide the controversy, it is necessary to determine the rights of a partner under the provisions of the Partnership Act.

12. In *Addanki Narayanappa and Another Vs. Bhaskara Krishtappa and Others*, a question arose whether a document recording the terms and conditions of dissolution which included a stipulation that one of the partners had given up his share in the machines, etc., and in the business, and made over the same to the other partners was compulsorily registrable u/s 17(1)(c) of the Registration Act. In that connection, the Supreme Court analysed the relevant provisions of the Partnership Act and observed as follows:

"From a perusal of these provisions it would be abundantly clear that whatever may be the character of the property which is brought in by the partners when the partnership is formed or which may be acquired in the course of the business of the partnership it becomes the property of the firm and what a partner is entitled to is his share of profits, if any, accruing, to the partnership from the realisation of this property, and upon dissolution of the partnership to a share in the money representing the value of the property. No doubt, since a firm has no legal existence, the partnership property will vest in all the partners and in that sense every partner has an interest in the property of the partnership. During the subsistence of the partnership however, no partner can deal with any portion of the property as his own. Nor can he assign his interest in a specific item of the partnership property to anyone. His right is to obtain such profits, if any, as fall to his share from time to time and upon the dissolution of the firm to a share in the assets of the firm which remains after satisfying the liabilities set out in clause (a) and sub-clauses (i), (ii) and (iii) of clause (b) of section 48..." (p. 404)

13. The Supreme Court quoted with approval the following statement of law from *Lindley on Partnership*, 12th edition:

"What is meant by the share of a partner is his proportion of the partnership

assets after they have been all realised and converted into money, and all the partnership debts and liabilities have been paid and discharged. This it is, and this only, which on the death of a partner passes to his representatives, or to a legatee of his share... and which on his bankruptcy passes to his trustee." (p. 375)

14. The Supreme Court summarized the position in the later portion of the judgment as follows:

"...his right during the subsistence of the partnership is to get his share of profits from time to time as may be agreed upon among the partners and after the dissolution of the partnership or with his retirement from the partnership of the value of his share in the net partnership assets as on the date of dissolution or retirement after a deduction of liabilities and prior charges...." (p. 407)

15. The Supreme Court held that though partnership assets included the immovable properties, there was no relinquishment of interest in any of the immovable properties by the outgoing partner and what he gets is merely by way of adjustment of the rights of the partners on dissolution by giving of his share in the net partnership assets after deduction of liabilities and prior charges and it was therefore not compulsorily registrable u/s 17(1)(c) of the Registration Act.

16. In Mohanbhai's case (supra), the Gujarat High Court held that the observations of the Supreme Court in Narayanappa's case (supra), are equally applicable where the partner retired from the partnership. In Mohanbhai's case (supra), Bhagwati, C.J. speaking for the Court succinctly summarized the rights of a partner as follows:

"...When, therefore, a partner retires from a partnership and the amount of his share in the net partnership assets after deduction of liabilities and prior charges is determined on taking accounts on the footing of notional sale of the partnership assets and given to him, what he received is his share in the partnership and not any consideration for transfer of his interest in the partnership to the continuing partners. His share in the partnership is worked out by taking accounts in the manner prescribed by the relevant provisions of the partnership law and it is this and this only, namely, his share in the partnership which he receives in terms of money. There is in this transaction no element of transfer of interest in the partnership assets by the retiring partner to the continuing partners:..." (pp. 402 - 03)

17. Mr. Suryanarayana Murthy, the learned counsel for the revenue submitted that the decision in Narayanappa's case (supra) related to a case arising u/s 17(1)(c) of the Registration Act and must be, therefore, held to be inapplicable. We do not agree. The language employed in section 17(1)(c) is analogous to section 2 (47). Section 17(1)(c) requires compulsory registration of a document where it acknowledges payment of consideration not only on account of creation, declaration, assignment or limitation but also on account of extinction of any right, title or interest in an immovable property, and the document in

Narayanappa's case (supra) could have, therefore, clearly required compulsory registration if there was any relinquishment or extinguishment of interest of one of the partners. We fail to see how the observations of the Supreme Court do not apply in the case of a retirement of a partner. The question is whether there is any relinquishment or extinguishment of rights in the partnership assets. That question depends upon the rights of a partner in the partnership assets and Narayanappa's case (supra) squarely decided the same.

18. In Commissioner of Income Tax, Gujarat-V Vs. Dilip Engineering Works,), it was held that where a retiring partner receives in lieu of his share in the partnership assets any cash or any other asset, no transfer of the asset was involved. Though this case arose in the context of the provisions of section 41(2), it is relevant to this extent namely, that no transfer is involved when a retiring partner receives at the time of retirement his share in the partnership assets either in cash or any other asset.

19. In Addl. Commissioner of Income Tax Vs. Smt. Mahinderpal Bhasin, , the Allahabad High Court followed the decision of the Gujarat High Court in Mohanbhai's case (supra) and held that when a partner retires, what he receives is really his share in the partnership assets. It is not a consideration for transfer of his interest in the partnership, to the continuing partners. In the case of a retirement of a partner, just as in the case of a dissolution of partnership, there is no element of transfer. It is only an adjustment of the rights of the partners and not relinquishment or extinguishment of interest of the retiring partner.

20. The same view was followed in Commissioner of Income Tax Vs. Madan Lal Bhargava, wherein it was observed that all that the assessee received on his retirement from the firm in respect of his share in the goodwill was its value to which he was all along entitled and that the case need not fall within the purview of section 2 (47) and, consequently, section 45 had no application.

21. Mr. Suryanarayana Murthy drew our attention to two decisions of the Bombay High Court in Commissioner of Income Tax, Bombay City-III, Bombay Vs. Tribhuvandas G. Patel, and Commissioner of Income Tax, Bombay City-II, Bombay Vs. H.R. Aslot, taking a contrary view. In the first case lump sum amount was paid to the retiring partner and the question arose whether it amounted to a transfer u/s 2 (47), The Bombay High Court drew a distinction between a case where a retiring partner gets his share of partnership after deducting the liabilities and taking up accounts on the foot of notional sale of partnership assets and where a lump sum amount is paid in consideration of the partner retiring without any accounting being done. It was held that in a case where the partner is paid a particular amount of money as his share in the partnership assets after accounting, it would not amount to a transfer, but where a lump sum amount is paid in consideration for his retirement in the partnership and the assignment of his interest to the other partners it would be transferred as defined in section 2 (47). Referring to the terms of the retirement deed, it was held that there was a transfer as defined by section 2 (47) and hence liable to

tax u/s 45. The other decision of the Bombay High Court also turned on the interpretation of the retirement deed following the view taken in Tribhuvandas's case (supra). Thus, in these two cases the decision turned upon the facts of the abovesaid cases. It is no doubt true as submitted by the learned counsel for the revenue that the Bombay High Court did not accept the principle in Mohanbhai's case (supra), that there is no distinction between a case of a retirement of the partner and dissolution of the partnership firm and that there can never be a transfer of a capital asset in the case of a retirement of a partner as there is no relinquishment of a capital asset or extinguishment of rights therein. With great respect, we are unable to agree with the view of the Bombay High Court. The rights of a partner are governed by the provisions of the Partnership Act. Otherwise by a mere description, the nature of the transaction can be altered. Further, the Gujarat High Court in Mohanbhai's case (supra) followed the decision of the Supreme Court in Narayanappa (supra) which laid down the proposition of law unequivocally.

22. Mr. Suryanarayana Murthy lastly contended that if there was no distinction between retirement of a member and dissolution of a firm section 47(ii) was unnecessary. But it may be mentioned that section 47(ii) deals not only with the case of dissolution of a firm, but also with cases of transfer by a BOIs and other AOPs. That apart, section 2 (47) has to be interpreted with reference to the language employed therein. Merely because section 47(ii) excludes the application of section 45 in case of dissolution of firms on the ground that no transfer is involved, it cannot be implied that a transfer is involved in the case of retirement. The converse or the opposite does not follow.

23. For the reasons given above, we agree with the view expressed by the Gujarat High Court in Mohanbhai (supra), which is based on the observations of the Supreme Court in Narayanappa (supra). The Tribunal was perfectly right in upholding the contention of the assessee that the sum of Rs. 46,500 received by him on his retirement is not assessable to capital gains. We answer the reference in the negative and in favour of the assessee with costs.