
(1992) 10 AHC CK 0026

In the Allahabad High Court

Case No : Income-tax Reference No. 95 of 1979

Commissioner of Income Tax

APPELLANT

Vs

Layallpur Engineering Co.

RESPONDENT

Date of Decision : 12-10-1992

Acts Referred:

Income Tax Act, 1961 — Section 155, 155(5), 33, 34, 34(3)

Citation : (1993) 202 ITR 332

Hon'ble Judges : R.K. Gulati, J;Om Prakash, J

Bench : Division Bench

Advocate : Rajesh Kumar Agarwal, for the Appellant;

Judgement

Om Prakash, J.—This is a reference by the Appellate Tribunal on the direction of this court u/s 256(2) of the Income Tax Act, 1961 (briefly "the Act"), which has stated the following questions for the opinion of this court :

"1. Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that the machinery was not transferred by the old firm which got the benefit of development rebate to the new firm ?

2, Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that the Income Tax Officer was not entitled to withdraw the development rebate originally granted within the provisions of Section 34(3)(b) read with Section 155(5) of the Income Tax Act, 1961 ?"

2. To appreciate the controversy, it is necessary to set out the facts elaborately.

3. The reference relates to the assessment year 1967-68 for which the previous year ended on March 31, 1967. In the next accounting year relevant to the assessment year 1968-69, the assessee-firm was constituted by six partners up to October 4, 1967. Three more partners were inducted on October 5, 1967. One of the original six partners, namely, Surajmal died on February 10, 1968. No business of the firm was carried on from February 11, to February 15, 1968. On

February 15, 1968, the, firm was constituted by eight partners and Smt. Shanti Devi, widow of Surajmal. The firm, therefore, filed two returns for the year 1968-69--one for the period ending February 11, 1968, and the other for the period February 15, 1968, to March 31, 1969. Before the Income Tax Officer, it was pleaded for the assessment year 1968-69 that there was the dissolution of the firm on February 11, 1968, when one of the partners died and, therefore, two separate assessments be made for the two broken periods. This plea was negatived by the Income Tax Officer who held that there was no dissolution, but merely a change in the constitution of the firm. He, therefore, made a single assessment for the assessment year 1968-69. The assessee filed an appeal before the Appellate Assistant Commissioner against the single assessment order. He reversed the order of the Income Tax Officer and held that the firm stood dissolved on February 11, 1968, when Surajmal (partner) died. He consequently directed the Income-tax Officer to make two separate assessments, one for the period up to February 11, 1968, for the assessment year 1968-69. The order of the Appellate Assistant Commissioner had become final, inasmuch as no appeal was filed against that order before the Appellate Tribunal. Therefore, the fact situation emerging from the order of the Appellate Assistant Commissioner for the assessment year 1968-69 was that the firm stood dissolved on February 11, 1968, upon the death of one of the partners, that absolutely a new firm came into being from February 15, 1968, and that no business was carried on by the firm during the interregnum period from February 11, 1968, to February 15, 1968.

4. For the assessment years 1965-66 to 1967-68, the assessee-firm which was then in existence (hereinafter referred to as the "old firm") was granted development rebate on the new plant or machinery having been installed thereby. As a consequence of the decision of the Appellate Assistant Commissioner relating to the assessment year 1968-69 against which no appeal was filed by the Revenue before the Appellate Tribunal, the Income Tax Officer was of the opinion that one of the consequences of the order of the Appellate Assistant Commissioner was that the assets for the purpose of which development rebate had been granted to the old firm for the consecutive assessment years 1965-66 to 1967-68 had been transferred to the new firm. Since such transfer had taken place within a period of eight years, the Income Tax Officer was of the further opinion that the development rebate had been wrongly allowed and that it was required to be withdrawn by taking action u/s 155(5) of the Act. He, therefore, passed an order u/s 155(5) of the Act on May 4, 1973, withdrawing the development rebate, granted on September 9, 1970, for the assessment year 1967-68, inter alia. The assessee appealed to the Appellate Assistant Commissioner against the order withdrawing the development rebate u/s 155(5) of the Act, which failed.

5. Then the assessee carried the dispute in further appeal to the Appellate Tribunal for the consecutive assessment years 1965-66 to 1967-68 raising the contention that the order passed by the Income Tax Officer and affirmed by the

Appellate Assistant Commissioner was erroneous, inasmuch as there was no transfer of the plant or machinery in respect of which development rebate was granted within the meaning of Section 34(3)(b) of the Act by the old firm to the new firm or to any other person. So far as the appeal for the assessment year 1965-66 is concerned, the Tribunal held that the order u/s 155(5) was barred by limitation, as that should have been passed on or before March 31, 1972, but was in fact passed on May 4, 1973. For the remaining assessment years 1966-67 and 1967-68, the Appellate Tribunal set aside the orders passed u/s 155(5) and held that the benefit of development rebate having been availed of by the old firm for the assessment years 1966-67 and 1967-68 could not be said to have been wrongly allowed and could not have been withdrawn u/s 155(5). But we are concerned in this reference only with the assessment year 1967-68.

6. For setting aside the order passed u/s 155(5) of the Act by the Income Tax Officer relating to the assessment years 1966-67 and 1967-68, the Appellate Tribunal held :

"But for the purposes of Section 155(5), it is not enough that there has been a transfer of the machinery or plant. This transfer must further have been made by the assessee to another person, the assessee being obviously the assessee which had been granted development rebate by the Income Tax Officer. In our opinion, this condition is not fulfilled in the present case. For purposes of the Income Tax Act, 1961, a firm is a separate entity. The assessee which has been granted development rebate in the present case is the firm which was being carried on in the name of Layallpur Engineering Company by nine partners including Surajmal. But on February 11, 1963, this firm got dissolved. On that date, or before the dissolution of the firm there was no transfer of assets by that firm to any new firm. Actually, there is no transfer deed in the present case. The transfer has simply been effected by delivery of possession and has been adopted by the partnership deed dated February 15, 1968, drawn up between the nine partners who constituted the new partnership with effect from January 15, 1968. This fresh partnership deed actually records that there had been suspension of business between the 11th and the 15th of February, 1968. Thus, the position is that on February 11, 1968, the firm got dissolved. Thereafter the assets of the firm, vested in the partners. The eight surviving partners and the legal representative of the 9th joined together and formed a partnership taking over the assets of the earlier firm. In other words, the transfer that was effected was a transfer by the partners of the previous firm and the legal representative of the deceased partner. It was not a transfer by the earlier firm to the new firm. To put it in other words, there was no transfer by the assessee which had got the benefit of the development rebate."

7. Clause (b) of Sub-section (3) of Section 34 of the Act, in so far as material, states that if any machinery or plant is sold or otherwise transferred by the assessee to any person at any time before the expiry of eight years from the end of the previous year in which it was acquired or installed, any allowance made u/

s 33 in respect of that machinery or plant shall be deemed to have been wrongly made for the purposes of this Act, and the provisions of Sub-section (5) of Section 155 of the Act shall apply accordingly.

8. Sub-section (5) of Section 155 of the Act enables the Assessing Officer to recompute the total income of the assessee for the relevant previous year and make the necessary amendment after withdrawal of the development rebate.

9. Sale or transfer of the machinery or plant by the assessee to any person before the expiry of eight years from the end of the previous year in which the machinery or plant was installed is a sine qua non for deeming the development rebate to have been wrongly made and for invoking the provisions of Sub-section (5) of Section 155 within the meaning of Section 34(3)(b) of the Act. The Appellate Tribunal clearly held that the plant or machinery installed by the old firm was neither sold nor transferred otherwise and, therefore, no action could have been taken u/s 155(5) of the Act by the assessing authority for the assessment year 1967-68, inter alia. The Tribunal also held that there was dissolution of the old firm on February 11, 1968, when one of the six partners died. The finding that the firm was dissolved on February 11, 1968, has become final inasmuch as, as already pointed out the order of the Appellate Assistant Commissioner who held that there was dissolution of the firm on February 11, 1968, was not challenged further in appeal by the Revenue before the Appellate Tribunal. What consequence can flow from the dissolution of the firm ? The Tribunal held that upon dissolution of the firm the assets of the firm vested in the erstwhile partners and the wife of the deceased partner who informed the partnership taking over the assets of the old firm.

10. The question for consideration is when a partnership is dissolved and the assets of the firm are distributed among the partners who later constitute a partnership by themselves taking a new partner, can it be said that there was a transfer of the assets by the old firm to the new firm ?

11. Let us have a look at the scheme of the Partnership Act as envisaged by Sections 14 : 15 : 29 : 32 : 37 : 38 and 48. 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 remain after satisfying the liabilities. (See Addanki Narayanappa and Another Vs. Bhaskara Krishtappa and Others, .

12. The whole concept of partnership is to embark upon a joint venture and for that purpose to bring in as capital money or even property including immovable property. Once that is done whatever is brought in would cease to be the exclusive property of the person who brought it in. It would be the trading asset of the partnership in which all the partners would have interest in proportion to their share in the joint venture of the business of partnership. The person who brought it in would, therefore, not be able to claim or exercise any exclusive right over any property which he has brought in, much less over any other partnership property. As already stated 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 the value of his share in the net partnership assets as on the date of dissolution or retirement after deduction of liabilities and prior charges.

13. It is, therefore, clear that upon the dissolution of the partnership, partners are entitled to get the value of their share in the net partnership assets as on the date of dissolution after deduction of liabilities and prior charges. Reverting to the question whether distribution of assets after dissolution entails a transfer, it must be held that upon the distribution of assets after dissolution of the partnership firm, there is no transfer within the meaning of Clause (b) of Sub-section (3) of Section 34 of the Act. The Supreme Court held in *Malabar Fisheries Co. Vs. Commissioner of Income Tax, Kerala*, :

"In order to attract Section 34(3)(b), it is necessary that the sale or transfer of assets must be by the assessee to a person. Dissolution of a firm must, in point of time, be anterior to the actual distribution, division or allotment of the assets that takes place after making up the accounts and discharging the debts and liabilities due by the firm. Upon dissolution the firm ceases to exist: then follows the making up of accounts, then the discharge of debts and liabilities and thereupon distribution, division or allotment of assets takes place inter se between the erstwhile partners by way of mutual adjustment of rights between them. The distribution, division or allotment of assets to the erstwhile partners, is not done by the dissolved firm. In this sense there is no transfer of assets by the assessee (dissolved firm) to any person." (underlining ours).

14. Dissolution being anterior to the distribution of assets in point of time, the contention of the Revenue that the taking over of the assets of the old firm by the new firm amounted to transfer by the old firm within the meaning of Section 34(3)(b) cannot be accepted. The Appellate Tribunal clearly found that the firm stood dissolved on February 11, 1968. It means that the old firm then came to an end. The Tribunal further found that no business was carried on between 11th and 15th February, 1968, and that the transfer was simply effected by delivery of possession when a new partnership deed dated February 15, 1968, was drawn

up between the partners who constituted the new firm, from these facts, it is apparent that the old firm was not in existence from 11th to 15th February, 1968, when the assets of the old firm were taken over by the new firm and adopted in the new partnership deed dated February 15, 1968. The old firm having ceased to exist on February 11, 1968, it cannot be said that that firm made a transfer of its assets to the new firm on February 15, 1968. The Tribunal is, therefore, right in holding that whatever transfer was made on February 15, 1968, that was made only by the erstwhile partners and by the widow of the erstwhile deceased partner, meaning thereby the newly inducted partner and not by the old firm. The requirement of Section 34(3)(b) is that the sale or transfer should be made by the assessee who availed of the benefit of development rebate.

15. Then, Sri Rajesh Kumar Agarwal, learned standing counsel, relying on *TARUN BHAI Vs. COMMISSIONER OF Income Tax.*, and several other authorities submitted that conversion of a proprietary business into a partnership amounts to a transfer of assets within the meaning of Section 34(3)(b) of the Act. Contribution of the assets or capital by a person carrying on proprietary business to a partnership concern may amount to transfer but that is not the question before us and on the basis of *TARUN BHAI Vs. COMMISSIONER OF Income Tax.*, , it cannot be successfully urged by standing counsel that by contributing assets of the old firm by the erstwhile partners which vested in them on dissolution into the business of the new firm, it amounted to transfer u/s 34(3)(b) by the old firm. It is significant to note that whatever arrangement was made regarding the assets belonging to the erstwhile partners of the old firm that was made on February 15, 1968, while the old firm ceased to exist on February 11, 1968, when it was dissolved. The old firm not being in existence on February 15, 1968, when the assets of the erstwhile partners were taken over by the new firm, transfer by the old firm to the new firm on February 15, 1968, could not be conceived.

16. Then standing counsel relied on the decisions *South India Steel Rolling Mills v. CIT* [1982] 135 ITR 322 and *Commissioner of Income Tax Vs. Mahabir Cold Storage*, of the Madras and Patna High Courts, respectively. Both the authorities seem to be misplaced by standing counsel, as in these authorities the point canvassed by standing counsel before us was not at all touched upon. In *South India Steel Rolling Mills"* case [1982] 135 ITR 322, the firm comprising two partners installed certain machinery and availed of development rebate. One of the partners died and then the firm stood dissolved. Surviving partners then constituted a new firm taking over all the assets of the dissolved firm. The Commissioner of Income Tax then passed an order u/s 263 of the Act cancelling the development rebate on the ground that by reason of the dissolution of the assessee-firm on the death of a partner, the development rebate reserve amount ceased to be utilised by the assessee for the full period of eight years following the installation of the machinery for the purposes of the assessee-firm's undertaking. In this view, he directed the Income Tax Officer to cancel the

development rebate already granted to the items of machinery in question. The Appellate Tribunal upheld the order of the Commissioner of Income Tax. The assessee then questioned the cancellation of development rebate by way of reference before the Madras High Court. It is noteworthy that in this case development rebate was not cancelled u/s 155(5) of the Act but a revisional order was passed by the Commissioner u/s 263 of the Act. The Madras High Court clearly pointed out that no question was raised by the assessor's counsel assailing the competence or jurisdiction of the Commissioner in taking proceedings in exercise of the revisional powers. In the case in hand, the benefit of development rebate was taken away by an order passed u/s 155(5). Therefore, the question for consideration before the Madras High Court was materially different and *South India Steel Rolling Mills*" case [1982] 135 ITR 322 cannot be an authority on the question we are required to consider in the instant reference. In *Commissioner of Income Tax Vs. Mahabir Cold Storage*, decided by the Patna High Court, the facts of the case briefly are : The firm in the name and style of Messrs. Prayagchand Hanumanmal comprising two partners carried on business at the Calcutta head office and at the branch office at Purnea with effect from May 3, 1956. The branch office at Purnea of the same partnership carried on business under the name and style of Sri Mahabir Cold Storage. The two partners took a loan from a private limited company, namely, Pariwal and Co. (P.) Ltd. for the erection and running capital of the cold storage. Subsequently, the said company was taken as a partner for better management of the business of the cold storage at Purnea. A fresh partnership deed was executed on November 10, 1958, in which the share of the aforesaid private limited company was fifty per cent. The newly constituted firm, namely, Sri Mahabir Cold Storage, which came into being to carry on business at Purnea only, was granted registration. The original firm consisting of the two partners, Prayagchand Periwal and Hanumanmal Periwal, carrying on business in Calcutta at the head office and at the branch office in Purnea, had installed machinery during the accounting year relevant to the assessment year 1959-60. After the new partnership for carrying on business at Purnea, came into existence from November 11, 1958, it claimed development rebate in the assessment year 1959-60 in respect of the cold storage plant and machinery. The Income Tax Officer disallowed the claim and held that as the assets transferred to the new firm constituted transfer u/s 54(3) (b) of the Act, the old firm was not entitled to development rebate. The appeal by the new Purnea firm to the Appellate Assistant Commissioner was dismissed. Upon further appeal, the Tribunal accepted the case of the new firm and development rebate which was earlier allowed to the old firm was allowed to the new firm. The Income Tax Officer passed an order u/s 155(5) withdrawing the development rebate for the assessment year 1960-61 holding that there was transfer of the plant or machinery for which the development rebate was allowed to the old firm during the assessment year 1959-60. On these facts the Patna High Court held (at page 694) :

"In the instant case, if the identity of the two firms was different, as assessable

identity was clearly so, then it is plain that in respect of the plant and machinery installed by the old partnership firm at Purnea, the new firm, a distinct and different assessable entity, could not claim development rebate either under the 1922 Act or under the 1961 Act. Whether the rebate granted to the old firm in the year 1959-60 was rightly withdrawn or wrongly withdrawn is not relevant for the purpose of considering the question of allowing rebate to the new firm. I am not concerned in the present reference to find out whether the order of the Tribunal in an appeal arising out of Section 155(5) proceedings was right or wrong. For the purpose of withdrawing the rebate it may well be, I shall assume to be so at the moment, that there was no sale or transfer within the meaning of Section 34(3)(b) of the 1961 Act. But I fail to understand how that fact by itself will entitle this new and distinct assessee to claim rebate in respect of the plant and machinery not installed by it but by another firm, the identity of which continued and was in existence even on the day the new firm was making the claim for development rebate."

17. It is, therefore, manifest that the Patna High Court considered the question whether the new firm in the lifetime of the old firm which installed the machinery, will be entitled to claim development rebate and then it took the view that the new firm which wanted development rebate, was not the assessee which had installed the new machinery and plant ; the assessee which had done so was different and, therefore, the new firm was not entitled to any development rebate in respect of the machinery and plant installed by the old firm. The Patna High Court did not consider the validity of the proceeding contemplated by Section 155(5) and had simply confined the question to consider whether the new firm can claim the development rebate in respect of the machinery or plant installed by another firm which also existed in the year when the development rebate was claimed. Both these authorities, therefore, do not benefit the Revenue at all in the instant reference.

18. For the above reasons, we uphold the order of the Tribunal in this regard and answer both the questions in the affirmative, that is, in favour of the assessee and against the Revenue. No order as to costs.