
(2014) 08 AP CK 0098

In the Andhra Pradesh High Court

Case No : Income Tax Tribunal Appeal No. 100 of 2002

Commissioner of Income Tax

APPELLANT

Vs

United Fish Nets

RESPONDENT

Date of Decision : 12-08-2014

Acts Referred:

Companies Act, 1956 — Section 575

Income Tax Act, 1961 — Section 2(31), 25(4), 260A, 45, 45(4)

Citation : (2015) 372 ITR 67 : (2015) 228 TAXMAN 302

Hon'ble Judges : T. Sunil Chowdary, J; L.N. Reddy, J

Bench : Division Bench

**Advocate : S.R. Ashok, Senior Standing Counsel, Advocate for the Appellant;
Ch. Dhanunjaya for P. Raj Kumar, Advocate for the Respondent**

Judgement

L. Narasimha Reddy, J.—The respondent is a firm constituted under the Partnership Act and was assessed to tax. In the assessment year 1993-94, it got itself transformed into a private limited company. The entire assets and liabilities of the respondent were made over to the company. The respective partners were issued shares by the company corresponding to the value of their share in the firm.

2. The Assessing Officer took the view that there was transfer of assets from the respondent to the private limited company and thereby the capital gains tax under Section 45 of the Income Tax Act, 1961 (for short "the Act") became payable. An order of assessment was passed to that effect on 29.03.1996. Aggrieved by that, the respondent filed an appeal before the Commissioner (Appeals). Through order, dated 12.04.1996, the Commissioner allowed the appeal. He took the view that Section 45(4) of the Act does not get attracted to the facts of the case. The Department filed further appeal being I.T.A. No. 61/HYD/93 before the Visakhapatnam Bench of the Income Tax Appellate Tribunal. Through its order, dated 31.01.2002, the Tribunal dismissed the appeal. Hence, this appeal under Section 260-A of the Act.

3. Sri S.R. Ashok, learned counsel for the appellant submits that the respondent is an independent legal entity from the point of view of the Act and once it has transferred its assets to a different legal entity viz., a private limited company, the transfer of assets took place and thereby the capital gains tax became payable. He submits that all the ingredients of Sub-section (4) of Section 45 of the Act are present in the instant case and that there was no basis for the Commissioner of Appeals and the Tribunal to reverse the order of assessment. He submits that the judgments relied upon by the Tribunal are distinguishable on facts and were rendered under a totally different legal regime. He places reliance upon certain precedents.

4. Sri Ch. Dhananjaya, learned counsel for the respondent, on the other hand, submits that this is a typical case, in which there was no dissolution of the respondent-firm in its strict sense and has simply been transformed from a firm into a private limited company. He submits that even if it is possible to assume that there is dissolution of the respondent-firm, there is no distribution of assets, since no partner of the respondent was passed on the assets corresponding to their share, much less there was distribution as contemplated under law. He places reliance upon the Judgment of the Bombay High Court in Commissioner of Income Tax Vs. Texspin Engg. and Mfg. Works, .

5. The facts are not in dispute, but the difference is only as to the legal consequences that have flown from them. The respondent is a firm registered under the Partnership Act. However, in the assessment year 1993-94, it got itself transformed into a private limited company, as provided for under Part IX of the Indian Companies Act. Except that the assets and liabilities of the respondent were en bloc transferred and made over to the newly formed company, no transaction of transfer in the ordinary parlance has taken place, much less any consideration was paid to the respondent.

6. The Assessing Officer took the view that the respondent stood dissolved, once a new company has come into existence in its place. As regards assets, he took the view that on allotment of shares by the company to the shareholders, who were none other than the partners of the respondent-firm, consideration stood paid for the respective extents of the assets. On this premise, the Assessing Officer levied the capital gains tax.

7. In the appeal preferred by it before the Commissioner, the contention of the respondent was that no distribution of assets has taken place and the transfer of assets was not to any individual company whatever. The Commissioner accepted the contention, and has allowed the appeal and set aside the order of assessment. Insofar as levy of capital gains tax, the same view taken by the Commissioner.

8. It is true that a partnership firm, which does not have any independent legal existence in the common law, is conferred with a semblance of status under the Act from the point of view of making it obligatory for a firm to file returns, to pay

income tax. The legal position on this aspect was explained by the Hon^{ble} Supreme Court, as it stood then, in *Commissioner of Income Tax, West Bengal Vs. A.W. Figgies and Co. and Others*, . Their lordships held:

"It is true that under the law of partnership, a firm has no legal existence apart from its partners and it is merely a compendious name to describe its partners but it is also equally true that under that law there is no dissolution of the firm by the mere incoming or outgoing of partners. A partner can retire with the consent of the other partners and a person can be introduced in the partnership by the consent of the other partners. The reconstituted firm can carry on its business in the same firm's name till dissolution. The law with respect to retiring partners as enacted in the Partnership Act is to a certain extent a compromise between the strict doctrine of English Common Law which refuses to see anything in the firm but a collective name for individuals carrying on business in partnership and the mercantile usage which recognizes the firm as a distinct person or quasi corporation. But under the Income Tax Act the position is somewhat different. A firm can be charged as a distinct assessable entity as distinct from its partners who can also be assessed individually."

9. On the same lines is the judgment of the Patna High Court in *Kaniram Ganpatrai v. Commissioner of Income Tax* 23 ITR 321, wherein it was observed that:

"It is true enough to state that a partnership is not in English law or in India law a single juristic person and a firm as such has no legal personality or existence. But for the purpose of the Income-tax Act a firm is regarded as having a separate existence apart from the partners who carry on the business. The question has recently been discussed by a Division Bench of this Court in *Jittanram Nirmalram Vs. Commr. of Income Tax*, , where the authorities on the point have been reviewed. It was held in that case that a new partnership of three persons was a different legal entity from an old partnership of four persons, though three of the partners were common. The same principle is laid down in *Income Tax Commissioners v. Gibbs* (1942) A.C. 402, in which the question arose whether a partnership of four stock brokers who took in a fifth partner ceased to carry on business and was succeeded by the partnership of five within the meaning of sub-rule I of Rule 9. Schedule D to the Income Tax Act, 1918, which provided that if a person charged under Schedule D ceased within the year of assessment to carry on the trade in respect of which the assessment was made and was succeeded by another person, the Commissioner shall adjust the assessment as directed. It was held by the House of Lords reversing the decision of the Court of Appeal that though in the English law a partnership was not a single juristic person, the scheme of the income-tax legislation treated the partnership as a legal entity for the purpose of assessing revenue and there was succession to the business within the meaning of Rule 9, sub-rules 1 and 2. Applying the principle of these authorities it is clear that in the present case there has been a succession to the partnership within the meaning

of Section 25(4) of the Indian Income Tax Act and that the finding of the Appellate Tribunal on this point is erroneous and should be overruled."

10. Therefore, whatever be the status of a firm, under the general law of the land, it can certainly be treated as a legal entity from the point of view of the Act. This is also evident from the definition of "person" under Section 2(31) of the Act, which includes not only an individual but also Hindu undivided family, company, firm, association of persons, local authority and every artificial juridical person, not falling within any of the preceding sub-clauses.

11. What however, becomes essential is whether the steps that are contemplated under Sub-section (4) of Section 45 of the Act have taken place in the instant case. Section 45(4) of the Act reads:

"The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or a co-operative society) or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place and, for the purposes of Section 48, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of the consideration received or accruing as a result of the transfer."

12. From a perusal of this, it becomes clear that two aspects become important viz., the dissolution of the firm and distribution of assets as a consequence thereof. Assuming that on its being transformed into a private limited company, the respondent ceased to exist and thereby, it stood dissolved, the liability to pay tax would arise, if only there is distribution of assets, as a result of such dissolution. Even according to the Department, the erstwhile partners of the respondent-firm did not receive the assets corresponding to their shares. What all had taken place is that they have been allotted shares in the company corresponding to their share of assets in the firm.

13. What constitutes distribution of assets under Section 45(4) of the Act was explained by the Bombay High Court in *Texspin Engineering and Manufacturing Worlds* case (1 supra). Incidentally, the facts of that case are identical with those in the present case. There also an existing firm was transformed into a company under Part IX of the Indian Companies Act. While dealing with the identical situation, wherein the Assessing Officer proposed to levy capital gains tax, the Bombay High Court held.

"In this case, the erstwhile firm has been treated as a Limited Company by virtue of Section 575 of the Companies Act. It is not in dispute that in this case, the erstwhile firm became a Limited Company under Part IX of the Companies Act. Now, Section 45(4) clearly stipulates that there should be transfer by way of distribution of capital assets. Under Part IX of the Companies Act, when a Partnership Firm is treated as a Limited Company, the properties of the erstwhile firm vests in the Limited Company. The question is whether such vesting stands

covered by the expression "transfer by way of distribution" in Section 45(4) of the Act. There is a difference between vesting of the property, in this case, in the Limited Company and distribution of the property. On vesting in the Limited Company under Part IX of the Companies Act, the properties vest in the company as they exist. On the other hand, distribution on dissolution presupposes division, realisation, encashment of assets and appropriation of the realised amount as per the priority like payment of taxes to the Government, BMC etc., payment to unsecured creditors etc. This difference is very important. This difference is amply brought out conceptually in the judgment of the Supreme Court in the case of *Malabar Fisheries Co. Vs. Commissioner of Income Tax, Kerala*, . In the present case, therefore, we are of the view that Section 45(4) is not attracted as the very first condition of transfer by way of distribution of capital assets is not satisfied. In the circumstances, the latter part of Section 45(4), which refers to computation of capital gains under Section 48 by treating fair market value of the asset on the date of transfer, does not arise."

14. The underlined portion, in a way, signifies the basic tenets of transfer of assets. The distribution must result in some tangible act of the physical transfer of properties or the intangible act of conferring exclusive rights vis-?-vis an item of property on the erstwhile shareholder. Unless these or other legal correlatives take place, it cannot be inferred that there was any distribution of assets. In the instant case, the shares of the respective shareholders in the respondent-company were defined under the partnership deed. The only change that has taken place on the respondent being transformed into a company was that the shares of the partners were reflected in the form of share certificates. Beyond that, there was no physical distribution of assets in the form of dividing them into parts, or allocation of the same to the respective partners or even distributing the monetary value thereof. In our view, the judgment of the Bombay High Court squarely covers the facts of the case and the orders passed by the Appellate Commissioner and the Tribunal accords with the same. The appeal is accordingly dismissed.

15. The miscellaneous petition filed in this appeal shall also stand disposed of. There shall be no order as to costs.