

(1996) 10 MAD CK 0092

In the Madras High Court

Case No : Tax Case No"s. 285 and 286 of 1982

Commissioner of Income Tax

APPELLANT

Vs

V. Krishnamoorthy and Another

RESPONDENT

Date of Decision : 08-10-1996

Acts Referred:

Income Tax Act, 1961 — Section 2(47), 28, 45, 47

Citation : (1998) 145 CTR 91 : (1998) 229 ITR 559

Hon'ble Judges : N.V. Balasubramanian, J;K.A. Thanikkachalam, J

Bench : Division Bench

Advocate : Deokinandan, for the Appellant; K.M.L. Majele, for the Respondent

Judgement

Thanikkachalam, J.—At the instance of the Department, the Tribunal referred the following three questions for the opinion of this Court, under s. 256(1) of the IT Act, 1961, hereinafter referred to as the "Act" :

"1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in confirming the deletion of the sum of Rs. 2,75,961 assessed as capital gains in the assessee's case ?

2. Whether, on the facts and in the circumstances of the case, and having regard to the provisions of s. 2(47) of the IT Act, 1961, the Tribunal was right in holding that there was no transfer when the assessee received certain amount over and above his capital for relinquishment of his right in the firm ?

3. Whether, on the facts and in the circumstances of the case, the Tribunal's finding that the capital gains of Rs. 2,75,961 is exempt under s. 47(ii) of the IT Act, 1961, is sustainable in law ?"

2. The two assessees Sri V. Krishnamoorthy and V. Rajagopalan were two of 19 partners in the firm of M/s. Rajagopalan Paper and Board Mills. Prior to 1st December, 1974 there were only four partners in the firm. On 1st December, 1974, fifteen new partners were taken into the firm. On 31st January, 1975,

according to the assessees, there was dissolution of the entire firm whereby four partners including the two assessees herein, were directed to be paid a sum of Rs. 2,50,000 each and also the shares and certain tangible assets and liabilities and such shares came to Rs. 25,961. The case of the assessees is that such sums came in the hands of each one of the assessees by way of dissolution of the partnership and hence, under s. 47(ii) of the Act, no capital gains is chargeable. On the other hand, the case of the Department is that there was only a retirement of the partners and the entire business continued with the remaining partners and the four partners only retired getting their share of interest. The ITO, relied on the decision of the Bombay High Court in Commissioner of Income Tax, Bombay City-III, Bombay Vs. Tribhuvandas G. Patel, . Thus, the ITO brought to capital gains tax the abovesaid sum of Rs. 2,75,961. The assessees preferred an appeal before the CIT(A). The CIT(A), after giving several reasons, allowed the claim of the assessees.

3. Aggrieved, the Department filed appeals before the Tribunal. The Tribunal held that a perusal of the deed of dissolution shows that the dissolution of the firm is complete. The Tribunal further held that the decision in Commissioner of Income Tax, Bombay City-III, Bombay Vs. Tribhuvandas G. Patel, , relied on by the Department is distinguishable on facts from the assessees" case. The Tribunal, however, relied on the decision of the Madras High Court in MAVUKKARAI (N) ESTATE TEA FACTORY Vs. ADDITIONAL COMMISSIONER OF Income Tax, MADRAS-II., . Considering the fact that each one of the 19 partners of the original firm is a party to the deed of dissolution, the Tribunal held that there was dissolution of the firm as envisaged in s. 43 of the Partnership Act. It observed that a relinquishment or extinguishment of the share in a partnership, without an assignment thereof, would not amount to a transfer within the meaning of s. 2(47) of the Act. The Tribunal found that in the assessees" case there was no such assignment and even cl. 3 of the deed of dissolution refers to a release and relinquishment and not to assignment. Considering the above, the Tribunal held that the dissolution of the firm is established on facts and the receipt of money by the assessee is not in consideration for transfer of a capital asset, but it was by way of distribution of the assets of the firm on dissolution. Thus, the Tribunal confirmed the order passed by the CIT(A).

4. Before us, the learned standing counsel appearing for the Department, submitted that the Tribunal was not correct in holding that there is dissolution of the firm as per the dissolution deed. But in reality there is continuation of the erstwhile firm, since some of the partners retired from the old firm. In the fresh partnership deed, dt. 1st February, 1975, it was stated that V. Rajagopalan, R. Vaidyanathan, R. Balasubramanian and V. Krishnamoorthy have since decided to retire from the said partnership w.e.f. 31st January, 1975, and in implementation of their decision, a deed of dissolution dt. 31st January, 1975, has been executed by all the partners of Sri Rajagopalan Paper and Board Mills, thereby terminating the partnership. Therefore, according to the learned standing counsel, what took place according to the earlier dissolution was only retirement of the partners

from the partnership firm and therefore, there is continuation of the erstwhile firm. According to the learned standing counsel, the Tribunal was not correct in holding that there was dissolution and on account of dissolution, each of the partners got their share in the partnership firm. Hence, there is no transfer attracting the provisions of s. 2(47) of the Act. On the other hand, the learned counsel appearing for the assessee, while supporting the order passed by the Tribunal, submitted that in the old partnership firm, there were 19 partners out of which four partners expressed their desire to retire from the partnership and on account of that all the partners agreed to dissolve the firm. In pursuance of such agreement, a deed of dissolution was drawn up and the erstwhile firm was dissolved. The remaining partners, apart from the four partners, who expressed their desire to retire from the partnership, along with some other partners formed a new partnership and executed a new partnership deed. Therefore, in this case, there is a clear dissolution of the erstwhile firm and the partners were allotted their shares according to their profit sharing ratio. Hence, no transfer would involve in such a transaction as contemplated under s. 2(47) of the Act, warranting levy of capital gain tax. The learned counsel further pointed out that in the new partnership deed, dt. 1st February, 1975, it is stated that four partners expressed their desire to retire from the firm and in accordance with that, the other partners also agreed to dissolve the firm, as a result of which, a dissolution took place. Therefore, the dissolution culminated from the desire expressed by four of the partners from retiring from erstwhile partnership. This would not mean, according to the learned counsel for the assessee, that there was retirement of the four partners and there was no dissolution of the erstwhile firm. Accordingly, the learned counsel for the assessee submitted that the Tribunal was correct in holding that there was dissolution of the erstwhile firm and the share of profit and loss allotted to the partners would not amount to transfer under s. 2(47) of the Act, warranting capital gain tax.

5. We have heard both the learned standing counsel appearing for the Department as well as the learned counsel appearing for the assessees. The fact remains that there was a original partnership firm, consisting of 19 partners. The partnership firm was constituted by a deed of partnership, dt. 1st December, 1974. Four partners expressed their desire to retire from the partnership. Thereafter, there was a deed of dissolution, dt. 31st January, 1975, which was drawn up with the consent of all the partners. After the deed of dissolution, fifteen out of 19 partners, started a new firm, along with some other persons under a deed of partnership, dt. 1st February, 1975. On dissolving the firm, four partners including the two assesseees herein were directed to be paid a sum of Rs. 2,50,000 and also the shares and certain tangible assets and liabilities and such share came to Rs. 25,961. According to the assessee, such sum came in the hands of each one of the assesseees by way of dissolution of the partnership firm and hence, under s. 47(ii) of the Act, no capital gain is chargeable. According to the Department, there was only retirement of the partners and the entire business continued with the remaining partners and the four partners only

retired, getting their share of interest. Therefore, capital gain tax is leviable on the amounts received by the assessee. The decision in this case depends upon the interpretation of the terms of the deed of dissolution, dt. 31st January, 1975.

The first four partners out of 19 partners of the firm formed one group and partners 5 to 19 formed the other group. The four partners expressed their desire to retire from the partnership. In pursuance of that, all the partners agreed to dissolve the firm. In pursuance of such agreement, a deed of dissolution was drawn up signed by all the 19 partners, dt. 31st January, 1975. There is no reference whatsoever to the business of the dissolved firm being continued. This deed refers only to the allotment of the assets and liabilities among the original partners and the continued partners. The fact of dissolution was intimated to the Sales-tax authorities, Central Excise Superintendent, Inspector of Factories, bankers, depositors and others. It is also published in the Official Government Gazette and given wide publicity by notice in Hindu on 15th February, 1975. The fact is that in the new partnership deed, dt. 1st February, 1975, it was stated that four of the partners expressed their desire to retire from the partnership, and therefore, all the partners decided to dissolve the firm and in pursuance of that, a deed of dissolution came into existence and the erstwhile firm was dissolved. This would not mean that there is continuation of the firm, since four of the partners expressed their desire to retire from the partnership. The desire of the four of the partners to retire from the partnership ultimately culminated to the dissolution of the firm, as per the deed of dissolution, dt. 31st January, 1975. Therefore, on facts, it was proved that there was a complete dissolution of the partnership firm by a dissolution deed, dt. 31st January, 1975. If the assets and liabilities were shared between the partners as per the profit sharing ratio, that would not amount to transfer under s. 2(47) of the Act, warranting levy of capital gain tax under s. 45 of the Act.

6. The Department followed the decision of the Bombay High Court in CIT vs. Tribhuvandas G. Patel (supra) wherein the Bombay High Court held that in the instant case having regard to the particular mode employed by the assessee and the continuing partners to effect and bring about retirement of the assessee from the partnership, the transaction will have to be regarded as amounting to "transfer" within the meaning of s. 2(47) of the Act, inasmuch as the assessee could be said to have assigned, released and relinquished his interest and share in the partnership and its assets in favour of the continuing partners and the transaction cannot be regarded as amounting to any distribution of capital assets upon dissolution of a firm. On the construction of the deed, dt. 19th January, 1962 and the mode in which the retirement of the assessee had taken place, the transaction must be held to amount to a "transfer" within the extended meaning of the expression as given in s. 2(47) of the Act and the consideration received by the assessee; therefore, will give rise to capital gains, chargeable to tax under s. 45 of the Act.

7. In COMMISSIONER OF Income Tax, TAMIL NADU-V Vs. N. PALANIAPPA

GOUNDER BY L. RS., , this Court, while dissenting from the view taken by the Bombay High Court in Commissioner of Income Tax, Bombay City-III, Bombay Vs. Tribhuvandas G. Patel, , held that when a partner retires from a firm and receives an amount in respect of his share in the partnership, what he receives is his own share in the partnership, and it is that which is worked out and realised. Whatever he receives cannot be gathered as representing some kind of consideration received by him as the result of a transfer or assignment or extinguishment or relinquishment of his share in favour of the other partners. Whether the retiring partner receives a lump sum consideration or whether the amount is paid to him after a general taking of accounts and after an ascertainment of his share in the net assets of the partnership as on the date of his retirement, the result, in terms of the legal character of the payment as well as the consequences thereof, is precisely the same.

8. Similarly, the Andhra Pradesh High Court in Commissioner of Income Tax Vs. P.H. Patel, , while dissenting from the view taken by the Bombay High Court in Commissioner of Income Tax, Bombay City-III, Bombay Vs. Tribhuvandas G. Patel, held "that for the purpose of s. 45 of the Act, no distinction could be drawn between an amount received by the partner on the dissolution of the firm and that received on his retirement, since both of them stood on the same footing. Therefore, the amount received by a partner from the partnership in excess of the capital and profits standing to his credit in the partnership books at the time of retirement cannot be construed as capital gain under s. 45 of the Act, inasmuch as there was no transfer within the meaning of s. 2(47) of the Act and the excess is not exigible to tax of capital gains."

9. The learned standing counsel appearing for the Department, relying upon the decision of the Andhra Pradesh High Court in Commissioner of Income Tax Vs. P.H. Patel, , submitted that without notice of dissolution under s. 43 of the Partnership Act, it is not possible to dissolve the firm. The Tribunal has pointed out that when all the partners of the partnership firm decided to dissolve the firm, there is no necessity to give a notice of dissolution as contemplated under s. 43 of the Partnership Act. It was further pointed out that when the dissolution took place as per the provisions of s. 40 of the Partnership Act also, there is no necessity for giving any prior notice for dissolution. In fact, s. 43 of the Partnership Act refers to one of the modes of dissolution. In the present case, it is clearly shown that all the partners of the erstwhile firm decided to dissolve the partnership firm and in pursuance of that, a dissolution deed was executed by all the partners and accordingly the erstwhile firm was dissolved, allotting shares to each of the partners in accordance with the profit sharing ratio. Under such circumstances, considering the facts arising in this case, in the light of the judicial pronouncements cited supra, we see that there is no infirmity in the order of the Tribunal in holding that there is no transfer in this case and accordingly capital gain tax under s. 45 of the IT Act, 1961, is not possible. In that view of the matter, we answer the questions referred to us in the affirmative and against the Department. No costs.