

(1980) 10 GUJ CK 0011
In the Gujarat High Court

Commissioner of Income Tax, Gujarat-V	APPELLANT
Vs	
Dilip Engineering Works	RESPONDENT

Date of Decision : 14-10-1980

Acts Referred:

Income Tax Act, 1961 — Section 2(47), 31(1), 32(1A), 34, 41(2)

Citation : (1981) 21 CTR 213 : (1981) 129 ITR 688

Hon'ble Judges : S.B. Majmudar, J; B.J. Diwan, J

Bench : Division Bench

Advocate : N.U. Raval, for the Appellant; J.P. Shah, for the Respondent

Judgement

Majmudar J.

1. The Commissioner of Income Tax, Gujarat-V, Ahmedabad, got two questions of law referred to us under s. 256(1) of the I.T. Act, 1961, by the Income Tax Appellate Tribunal, Ahmedabad Bench `B". The referred questions are as under :

"(1) Whether, on the facts and in the circumstances of the case, and having regard to clauses 9, 12 and 13 of the partnership deed dated 18th November, 1966, the finding of the Tribunal that addition of Rs. 14,924 as profit u/s 41(2) of the Act was not justified is correct in law ?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the value of machinery and land received by the partners as per the terms of the partnership deed on retirement, is not a transfer which attracted the provision of section 41(2) of the Income Tax Act, 196 ?"

2. The facts leading to this reference are as under. The assessee is a partnership firm styled as M/s. Dilip Engineering Works. It operated in Udyognagar, Rajkot. It originally consisted of four partners : (1) Mansukhlal Odhavji; (2) Popatlal Kunverji; (3) Mohanlal Chakubhai, and (4) Dhirajlal Popatlal. The concerned assessment year is 1968-69 covering accounts of the S. Y. 2023. On July 7, 1967, which fell in the material accounting year, two of the aforesaid partners,

viz., Popatlal and Dhirajlal, retired from the partnership firm under a deed dated September 7, 1967, and under the terms of the retirement, the partners were given machinery and land at the values mentioned therein. The value of the machinery taken by Popatlal and debited to his account was Rs. 26,689 and value of the land taken by Dhirajlal and debited to his account amounted to Rs. 9,804. Besides, tools worth Rs. 1,163 were also given to the retiring partners. The ITO considered that as a result of the retirement of the two partners from the firm, there was only a change in the constitution of the firm and not any dissolution thereof and that as the firm had continued, allotment of the machinery to the retiring partners at the stated value amounted to a sale which attracted the provisions of s. 41(2) of the Act since the machinery in question had been allowed depreciation in the past. He, therefore, brought to charge the total sum of Rs. 14,924 in this connection. The assessee-firm carried the matter in appeal. The AAC accepted the contention of the assessee that there was no transfer of any asset in favour of the retiring partners which could be brought to tax under s. 41(2) of the Act. The AAC, in arriving at the aforesaid conclusion, relied heavily on a decision of this court in *Velo Industries Vs. Collector, Bhavnagar*. He, accordingly, deleted the addition of Rs. 14,924 to the income of the assessee-firm as made by the ITO.

3. The revenue thereafter carried the matter in a further appeal to the Income Tax Appellate Tribunal. The Tribunal held that the department's objection had no substance and accordingly dismissed the appeal of the revenue. Thereafter, the revenue got two questions of law referred to us for our opinion. We have already extracted these questions in the earlier part of this judgment.

4. In order to appreciate the controversy posed for our consideration in the present proceedings, it is necessary to have a look at the relevant statutory provisions which applied during the assessment year in question. Section 41(2) reads as under :

"(2) Where any building, machinery, plant or furniture which is owned by the assessee and which was or has been used for the purposes of business or profession is sold, discarded, demolished or destroyed and the moneys payable in respect of such building, machinery, plant or furniture, as the case may be, together with the amount of scrap value, if any, exceed the the written down value, so much of the excess as does not exceed the difference between the actual cost and the written down value shall be chargeable to Income Tax as income of the business or profession of the previous year in which the moneys payable for the building, machinery, plant or furniture became due....."

5. Explanation 2 to the aforesaid section reads as under :

"For the purposes of this sub-section, the expression `moneys payable' and the expression `sold' shall have the same meaning as in sub-section (1A) of section 32."

6. Sub-section (1A) of s. 32 provides as under :

"(1A) Where the business or profession is carried on in a building not owned by the assessee but in respect of which the assessee holds a lease or other right of occupancy and any capital expenditure is incurred by the assessee for the purposes of the business or profession after the 31st day of March, 1970, on the construction of any structure or doing of any work in or in relation to, and by way of renovation or extension of, or improvement to, the building, then, in respect of depreciation of such structure or work, the following deductions shall, subject to the provisions of section 34, be allowed -

(i) such percentage on the written down value of the structure or work as may in any case or class of cases be prescribed;

(ii) in the case of any such structure or work which is sold, discarded, demolished, destroyed or is surrendered as a result of the determination of the lease or other right of occupancy in respect of the building in the previous year (other than the previous year in which it is constructed or done) the amount by which the moneys payable in respect of such structure or work together with the amount of scrap value, if any, fall short of the written down value thereof :

Provided that such deficiency is actually written off in the books of the assessee.

Explanation. - For the purposes of this clause, -

(i) `moneys payable", in respect of any structure or work, includes -

(a) any insurance or compensation moneys payable in respect thereof;

(b) where the structure or work is sold, the price for which it is sold; and

(ii) `sold" shall have the meaning assigned to it in the Explanation to clause (iii) of sub-section (1)."

That takes us to clause (iii) of sub-s. (1) of s. 32. The said provision reads as under :

"Explanation. -.....

(2) `sold" includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company."

7. Against the background of the aforesaid statutory provisions, the question which has been posed for our opinion in the present proceedings had to be answered. It is an admitted fact on the record of this case that the partnership in question came into existence in November, 1968. A partnership deed to that effect was duly executed between the parties. It was a partnership at will as provided by clause 9 of the said partnership deed. The said clause stated that the partnership shall last as long as the partners work together amicably, i.e., this partnership is at will. Thereafter, clause 13 of the deed provided as under :

"That if any one of the partners, desired to retire he shall have to give one month's notice of his intention to do so. The value of the machinery of the factory, as may be determined by the arbitrator, and all other liabilities as on that date, entries regarding profit and loss account shall be passed. And that the retiring partner can retire after paying off the debt of the firm, if any. If such a partner has any credit balance then for the sake of convenience of the working of the firm, the firm shall pay such amount to the retiring partner in 6 equal instalments."

8. Originally there were four partners. Out of these four partners, two of the partners retired during the previous year relevant to the assessment year under reference. At that time, in lieu of their interest and share in the partnership assets, certain machinery and land were allocated to them. The ITO himself has noted that the retiring partners have exchanged their interest in the firm by taking over machineries, land, etc. According to the ITO, this amounted to sale of machineries and land to the retiring partners in view of the fact that the firm was not dissolved but continued to exist so far as the remaining partners were concerned. The short question for our consideration is. Whether allotment of machineries and land to the retiring partners in lieu of their shares will amount to sale of the concerned shares to them so as to attract s. 41(2) of the Act which we have already reproduced earlier ? The connotation of the term "sale" as contemplated by s. 41(2) has to be gathered from the definition of the word "sale" or "sold" as found in s. 32(1)(iii), Explan., clause (2). We have to consider the said Explanation for the purpose of finding out as to whether any sale took place in favour of the concerned partners when they were allotted these properties in lieu of their existing shares in the partnership assets. It is obvious that there was strictly speaking no sale in their favour nor was there any transfer by way of compulsory acquisition by them of any assets as contemplated by the aforesaid Explan., clause (2), to s. 31(1)(iii). Consequently, it cannot be said that when machineries and land were allotted to the concerned retiring partners in lieu of their share, and even though the said allotment was made on considering the cost price of these machineries and land and even though the written down value of the machineries in the books of the firm at the relevant time was less as compared to the cost price of these machineries, these machineries were sold to them so that the transaction in question could attract the provisions of s. 41(2) of the Act. It is now well settled by a couple of decisions of the Supreme Court as well as this court to which we will presently refer that when a partner is allotted any asset in lieu of his existing share in the partnership assets, it cannot be said that any transfer of such asset takes place in his favour so as to attract the provisions of s. 45 or s. 41(2) of the Act.

9. In Commissioner of Income Tax, Madhya Pradesh Vs. Dewas Cine Corporation, , the Supreme Court had an occasion to consider the question whether any liability to pay the balancing charge arose on dissolution of the partnership. In the case before the Supreme Court, S and H, each of whom owned a cinema theatre, formed a partnership to carry on business in

partnership as exhibitors of cinematograph films, bringing the theatres into the books of the partnership as its assets. For the assessment years 1950-51 to 1952-53, the ITO allowed depreciation aggregating to Rs. 44,380 in the assessments of the partnership in respect of the two theatres. On the dissolution of the partnership on September 30, 1951, it was agreed between S and H that the theatres should be returned to their original owners. In the books of account of the partnership, the assets were shown as taken over at the original price less the depreciation allowed, the depreciation being equally divided between S and H. The Tribunal held that by restoring the theatres to the original owners, there was a transfer by the partnership and the entries adjusting the depreciation and writing off the assets at the original value amounted to total recoupment of the entire depreciation by the partnership and on that account the second proviso to s. 10(2)(vii) of the Indian I. T. Act, 1922, applied. In that connection, the Supreme Court observed (headnote of 68 ITR 240) :

"On the dissolution of the partnership, each theatre had to be deemed to be returned to the original owner in satisfaction partially or wholly of his claim to that share in the residue of the assets after discharging the debts and other obligations. But thereby the theatres were not in law sold by the partnership to the individual partners in consideration of their respective shares in the residue, and, therefore, the amount of Rs. 44,380 could not be included in the total income of the partnership under the second proviso to section 10(2)(vii)."

10. It was further observed in this connection (headnotes of 68 ITR 240) :

"The expressions `sale' and `sold' are not defined in the Income Tax Act; those expressions are used in section 10(2)(vii) in their ordinary meaning. `Sale', according to its ordinary meaning, is a transfer of property for a price, and adjustment of the rights of the partners in a dissolved firm by allotment of its assets is not a transfer, nor is it for a price."

11. The second decision of the Supreme Court on the point is Commissioner of Income Tax, U.P. Vs. Sh. Bankey Lal Vaidya (Dead) by Lawyers, . The question before the Supreme Court in the aforesaid decision was as to whether a partner, on dissolution, was making any capital gains where his share in the assets of the partnership firm was being allotted to him on dissolution. The contention of the revenue was that such a transaction did amount to capital gains to the concerned partner. Repelling that submission on behalf of the revenue, the Supreme Court observed (headnote) :

"There was no sale or exchange of the respondent's share in the capital assets....."

In the course of dissolution, the assets of a firm may be valued and the assets divided between the partners according to their respective shares by allotting the individual assets or paying the money value equivalent thereof. This is a recognised method of making up the accounts of a dissolved firm. In that case the receipt of money by a partner is nothing but a receipt of his share in the

distributed assets of the firm."

12. So far as this court is concerned, in *Velo Industries Vs. Collector, Bhavnagar*, a Full Bench of this court dealt with the question whether the allotment of assets towards the share of a retiring partner amounted to any sale which was liable to stamp duty under the provisions of the Bombay Stamp Act, 1958. The Full Bench of this court took the view that on such an occasion, no question of sale ever arose. It was observed in that connection (headnote) :

"When a partner retires from the partnership and the amount of his share in the net partnership assets after deducting liabilities and prior charges is determined on taking accounts on the footing of a notional sale of the partnership assets and given to him, what he receives is his share in the partnership and not any price for sale of his interest in the partnership. There is, in such a transaction, no element of sale within the meaning of art. 25, clause (b) of Sch. I to the Bombay Stamp Act, 1958.

It is true the aforesaid decision of the Full Bench of this court was given in a reference under the Stamp Act, 1958. But the legal position on the point is clearly laid down by the aforesaid Full Bench decision on the point. There is a later decision of this court in *CIT v. Mohanbhai Pamabhai* [1973] 91 ITR 393, which squarely answers the questions posed for our consideration against the revenue. A Division Bench of this court in the aforesaid decision was concerned with the question whether on the retirement of a partner from a firm any amount received by him in respect of his share in the partnership was liable to be brought to tax as capital gains under s. 45 of the Act. The revenue in the aforesaid case had relied upon the word "transfer" in s. 2(47) of the Act. It was observed by this court in that connection (p. 394) :

"This definition gives an artificially extended meaning to the term by including within its scope and ambit two kinds of transactions which would not ordinarily constitute 'transfer' in the accepted connotation of that word, namely, relinquishment of the capital asset and extinguishment of any rights in it. But, even in this artificially extended sense, there is no transfer of interest in the partnership assets involved when a partner retires from the partnership."

13. It was further observed (p. 394) :

"The interest of a partner in a partnership is not interest in any specific item of the partnership property. It is a right to obtain his share of profits from time to time during the subsistence of the partnership and on dissolution of the partnership or on his retirement from the partnership to get the value of his share in the net partnership assets which remain after satisfying the debts and liabilities of the partnership. 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 receives 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, 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."

14. It was further pointed out (p. 394) :

"The transfer of a capital asset in order to attract capital gains tax must be one as a result of which consideration is received by the assessee or accrues to the assessee. When a partner retires from a partnership what he receives is his share in the partnership which is worked out and realised and does not represent consideration received by him as a result of the extinguishment of his interest in the partnership asset"

15. The aforesaid decisions of the Supreme Court and of this court clearly lay down that where a retiring partner receives, in lieu of his share in the partnership assets, any cash amount or any other asset, it cannot be said that any asset is transferred to him or is sold to him so as to attract the provisions of s. 41(2) or, for that matter, s. 45 of the Act. In any case, it can easily be seen in the light of the relevant statutory provisions as they held the field during the relevant assessment year that when the concerned retiring partners were allotted machineries and land in lieu of their shares in the partnership assets, nothing was sold to them by partnership firm which could result in any balancing charge liable to be brought to tax under s. 41(2) of the Act.

16. Mr. Raval, for the revenue, contended that the decisions of the Supreme Court and this court were rendered with reference to situations wherein the assets of the partnership were ascertained on dissolution of the firm. But in the present case, the concerned partners had retired when there was no dissolution of the firm as such and the firm continued to exist and the remaining partners carried on the business. In our view, this fact makes no difference. Even though the retiring partners go out and the rest of the partners continue the business of the firm and there is no general dissolution of the partnership, even, then, so far as the retiring partners are concerned, their shares in the partnership assets have to be ascertained and whatever falls due to them has to be given to them to square off their accounts. If any machinery is allotted to them in lieu of their shares, it cannot be said that the said machinery is sold by the firm to the concerned partners during the relevant years so as to attract the provisions of s. 41(2). Mr. Raval, for the revenue, contended that, in a given case, same assets of the partnership may be sold to the retiring partners by the other partners who continued to carry on the business of the firm. It is possible to visualise such a contingency. But so far as the facts of the present case are concerned, it is ascertained that, on retirement, the partners were allotted machineries and land in lieu of their shares in the partnership assets. It is not as if the retiring partners of their own volition selected some assets and purchased them from the other

partners. Consequently, the question of the applicability of s. 41(2) of the Act can never arise on the facts of the present case.

17. Mr. Raval, in support of his submission, invited our attention to a few decisions of the Bombay High Court. He first of all took us to a decision in Bhavnani Bus Service Co., Bombay Vs. Commissioner of Income Tax, Bombay City-II, . This decision was pressed into service by Mr. Raval in support of his submission that if a partnership is not dissolved, even though it gets reconstituted from time to time and if the said partnership firm sells some of its assets which bring about a situation in which a balancing charge liable to tax arises, such an amount can be brought to tax. In Bhavnani Bus Service Co., Bombay Vs. Commissioner of Income Tax, Bombay City-II, , the High Court of Bombay had to consider a case in which in spite of the existence of three different partnership firms, one after the other, the facts on record showed that there was no dissolution of the earlier firms and the firm in question had sold four buses for Rs. 29,800. The question was whether the difference between the written down value of the buses in question and the price at which they were sold could be brought to tax under the provisions of s. 10(2)(vii) of the Indian I. T. Act, 1922, which was applicable then. The Bombay High Court took the view that this transaction was liable to be brought to tax. In that connection, it was observed (p. 180) :

"The mere circumstance that the parties chose to construe certain facts as amounting to a dissolution of a partnership would not be conclusive in deciding whether a partnership was in fact dissolved."

18. It was further observed (p. 180) :

"There was no evidence of the dissolution of the two previous firms. There was, therefore, no dissolution and formation of new firms but mere changes in the constitution of the firm. The excess realised over the written down value of the buses was taxable. As written down value given in the books of account of the assessee was Rs. 18,328 and there was no dispute regarding this amount, the sale proceeds as reduced by this sum i.e., Rs. 11,472, were taxable u/s 10(2)(vii)."

19. The aforesaid decision of the Bombay High Court can be of no real assistance to Mr. Raval for the simple reason that in the present case, machineries are not sold to outsiders as was the case before the Bombay High Court in Bhavnani Bus Service Co., Bombay Vs. Commissioner of Income Tax, Bombay City-II, . It may be that the firm in question continued to exist. But so far as the machineries and land are concerned, they were allotted to the retiring partners in lieu of their share in the partnership assets. Consequently, the aforesaid Bombay decision cannot be of any assistance to the revenue in the present case when it stands on its own facts. Thereafter, Mr. Raval took us to a later decision of the Bombay High Court in Commissioner of Income Tax, Bombay City-III, Bombay Vs. Tribhuvandas G. Patel, . The question before the Division Bench of the Bombay

High Court in that case was whether any amount paid to a retiring partner which came to be allotted to him in lieu of his share in the partnership assets can be brought to tax as capital gains under s. 45 of the Act. It is true that in the aforesaid decision, the Bombay High Court took the view that on the retirement of a partner from a firm, what is allotted to him amounted to "gains" to the concerned partner. But it must be noted that the aforesaid decision of the Bombay High Court considered the question posed before it in the light of s. 45 read with s. 47(ii) and in accordance with the wider definition of the term "transfer" as incorporated in s. 2(47) of the Act. It is pertinent to note that so far as the present case is concerned, we are not dealing with the question of any capital gains accruing to the retiring partner, wherein the wider definition of the term "transfer" under s. 2(47) of the Act may have its play, though we may mention that even such a wider question has been squarely answered against the revenue by the Division Bench of this court in Mohanbhai Pamabhai's case [1973] 91 ITR 393 , and hence the decision of the Bombay High Court in Commissioner of Income Tax, Bombay City-III, Bombay Vs. Tribhuvandas G. Patel, , in so far as it takes a contrary view, cannot be effectively availed of by the revenue so far as this court is concerned. But without going into that wider question, we may point out that so far as the question of balancing charge is concerned, in the light of the relevant statutory provisions as existed during the assessment year in question, it cannot be said that any machinery allotted to the partners on retirement, attracted the provisions of s. 41(2) of the Act. Under these circumstances, we need not dilate any further on the decision of the Bombay High court in Commissioner of Income Tax, Bombay City-III, Bombay Vs. Tribhuvandas G. Patel, .

20. As a result of the aforesaid discussion, it must be held that the Tribunal was right when it held that, in the facts and circumstances of the present case, addition of Rs. 14,924 as profit under s. 41(2) of the Act was not justified in law and that the transaction did not envisage a sale which attracted the provisions of s. 41(2) of the Act. Hence, our answers to the questions referred to us are as under :

Question No. 1. - In the affirmative, that is, in favour of the assessee and against the revenue.

Question No. 2 - In the affirmative, that is, in favour of the assessee and against the revenue.

21. The Commissioner will pay costs of this reference to the assessee Orders accordingly.