
(1971) 03 MAD CK 0027

In the Madras High Court

Case No : Writ Petition No. 1041 of 1967

Jagadishchandra F. Modi

APPELLANT

Vs

Joint Commercial Tax Officer, Harbour Division II and Others

RESPONDENT

Date of Decision : 10-03-1971

Acts Referred:

Partnership Act, 1932 — Section 39, 46, 48

Citation : (1972) 29 STC 144

Hon'ble Judges : Ramaprasada Rao, J

Bench : Single Bench

Advocate : S.C. Shah, for the Appellant; K. Venkataswami, First Assistant Government Pleader, for the Respondent

Final Decision : Allowed

Judgement

Ramaprasada Rao, J.—The firm of Messrs J. Prataprai and Company, which was a partnership firm, was dissolved on 31st March, 1966. The petitioner was one of the partners of the quondam firm. On 31st March, 1966, a dissolution of the partnership was effected by a deed in writing and the scheme of dissolution was set out in the said instrument. For the year 1965-66 the firm was assessed to sales tax under the provisions of the Madras General Sales Tax Act, 1959. The assessing officer, after scrutinising the deed of dissolution, found that stocks of the value of Rs. 97,790 were taken over by one of the partners in lieu of his share of the capital and assets of the quondam partnership firm. In that connection and consequent upon the accounting and adjustment as agreed to, the petitioner and another took over stocks of the value of Rs. 97,790. In the return submitted by the quondam partnership firm for the assessment year in question, this turnover was not brought in, as, according to the petitioner, there was no transfer of property by one to the other for valuable consideration and, therefore, there was no sale of stocks of the value of Rs. 97,790 from one set of partners to the other set of partners who took over such stocks. The assessing authority, in the course of assessment proceedings, was of the view that the

quondam partnership firm which was a registered dealer, did not disclose in its returns the aforesaid turnover which, according to the assessing authority, represented the sale value of the goods sold to the petitioner and another. He, therefore, proposed to bring to tax such a turnover which was not brought into the returns, and also proposed to levy a penalty for the non-disclosure of the turnover in the usual course. Relying upon clause 5 in the deed, which stated that the stock-in-trade belonging to the partnership business was taken over by the petitioner and another at the book value, the assessing authority being of the view that such taking over constitutes a sale of stock by the partnership firm to two of its quondam partners and as Rule 6(d) of the Madras General Sales Tax Rules, 1959, was not available to the petitioner to claim an exemption, rejected the objection regarding the inclusion of the turnover as above and brought it to tax. The petitioner unsuccessfully appealed to the Appellate Assistant Commissioner who confirmed the order of assessment including the levy of penalty. In the matter of the quantum of penalty, however, there was a reduction. It is as against the order of the Appellate Assistant Commissioner dated 25th February, 1967, the present writ petition has been filed. The claim of the petitioner is that the turnover which is relatable to transactions and adjustments made inter se between partners of a partnership firm in the course of dissolution does not reflect the ordinary elements which should be present in a sale, and there being no sale, no sales tax is leviable and a fortiori a penalty on the alleged escapement of turnover. It is contended that the instrument of partnership merely reflects a scheme of accounting and adjustment of the rights of partners and in order to implement such an agreed formula amongst the quondam partners of the firm if any stock is taken over or transferred at the book value from one set of partners of the firm to the other group of partners, it is only in the normal course of adjustment of rights of partnership assets and such transaction does not involve a transfer of property in the goods from one to the other and therefore not a sale. The learned Government Pleader appearing for the revenue contends to the contrary.

2. What is dissolution of a partnership firm ? It is a technical expression. u/s 39 of the Partnership Act "the dissolution of partnership between all the partners of a firm is called the dissolution of the firm." As partnership springs from a contract and as a contract could be discharged by mutual agreement, so also the jural relationship created by an agreement between partners could be severed by extinguishing or breaking away the partnership firm and snap the concept of mutual agency as between quondam partners. Such a dissolution can be made orally as between the partners evidenced by the supervening conduct and the attitude of the parties to so break away and extinguish the firm. For convenience, however, it is normally effected by an instrument in writing, called the deed of dissolution of partnership. In the ultimate analysis, it is the intention of the partners which governs the issue. The question whether a partnership is dissolved is always a mixed question of law and fact. Section 46 of the Partnership Act refers to the right of partners to have their business wound up by

dissolution.

46. On the dissolution of a firm every partner or his representative is entitled, as against all the other partners or their representatives, to have the property of the firm applied in payment of the debts and liabilities of the firm, and to have the surplus distributed among the partners or their representatives according to their rights.

3. The section reaffirms the well-known rights of a partner which is commonly known as his general lien on the surplus assets of the firm. Such an equitable partner's lien enables him to cause the available surplus to be distributed amongst the partners in accordance with their accredited rights in the partnership. The mode of settlement of accounts between the partners is again a matter of contract. In the absence of such contract, Section 48 of the Partnership Act comes into play and the rights of partners of a dissolved firm are thus adjusted.

4. I have referred to the above salient general principles only to reaffirm that the accounting which follows dissolution of a partnership firm is a natural corollary of the event of dissolution of a partnership firm. Such an adjustment of rights over the surplus assets flows from the well-known concept of a partner's lien over the same. Such a distribution and adjustment of the available surplus, amongst the quondam partners after extinguishing the partnership as such, does not involve a transfer of property by one partner to another for valuable consideration. If any stock is allotted to a partner in the course of such a dissolution, or if any property is earmarked as the asset of a partner after dissolution in lieu of his share in the totality of the erstwhile partnership assets, and if in consequence of such an allotment, adjustment and accounting, it becomes necessary for one partner to pay money to the other or others after allocating the shares so as to effect a just and equitable distribution of the partnership assets, in accordance with the admitted shares of partners, then by no means of understanding such a transaction can be called a sale by one partner to the other for consideration or a sale by the quondam firm to one of its partners for consideration. Distribution of assets and receipt of money so as to adjust rights on dissolution in accordance with the original terms of the partnership are events which are totally unconnected with the concept of a sale as is legally or popularly understood.

5. In *State of Gujarat v. Ramanlal Sankalchand and Company* [1965] 16 S.T.C. 329 the Gujarat High Court had occasion to consider the vires of Section 26(3) of the Bombay Sales Tax Act which purported to bring to tax, allotment of goods of a firm amongst the partners on the dissolution of the firm fictionally as a sale. The learned Judges held that such allotment did not fall expressly within the subject of legislation contained in entry 54 in List II of the Seventh Schedule to the Constitution and therefore were of the view that it was constitutionally impermissible to the State Legislature to treat such an allotment as a sale within the meaning of the Indian Sale of Goods Act. When the net assets of a partnership firm are divided amongst the partners in specie, no money

consideration passes though for all legal purposes such a division is supported by consideration since one partner is taking his interest in the partnership property in specie and is, therefore, bound to pay its value in excess of his share to the others. But such consideration can by no stretch of imagination be called a money consideration.

6. The Supreme Court in Commissioner of Income Tax, Madhya Pradesh Vs. Dewas Cine Corporation, . while considering the import of the words "sale" and "sold" under the provisions of the Income Tax Act, 1922, observed that "sale", which expression is not defined in the Income Tax Act, is to be understood in its ordinary meaning as a transfer of property for a price, and adjustment of the rights of partners in a dissolved firm is not a transfer nor it is for a price.

7. The Kerala High Court in Hamsa Haji v. Sales Tax Officer [1967] 20 S.T.C. 470 observed that a transaction like the one referred to in this writ petition does not involve any sale of goods and the transferor does not part with property in the goods. He only shares his rights therein with the other partners under the contract of partnership.

8. In Commissioner of Income Tax Vs. Janab N. Hyath Batcha Sahib, a Division Bench of this court, to which I was a party, after compendiously describing the real concept of a partnership firm, observed:

...when a person hands over his property to a firm of partners consisting of himself and others, there is no transfer of property so as to constitute a sale of goods as defined in the Sale of Goods Act.

9. A Full Bench of this court, while dealing with the provisions of the Gift-tax Act, 1958, and particularly the position where a Mitakshara father decides to treat his self-acquired property as the property of the family, in The Commissioner of Gift Tax, Madras Vs. P. Rangasami Naidu, held the view that such conversion of separate property into joint family property does not involve any transfer or disposition of property within the meaning of Section 2(xxiv) of the Gift-tax Act, 1958. The learned Judges were of the view that such conversion by blending or throwing it in the hotchpot of the joint family cannot be construed as a transfer of property as there is no increase in the value of the property previously held by the undivided family and the transaction involved an addition to the asset by one member adding to it.

10. All the above decisions do lay down and support the opinion already expressed by me that no sale is involved when the stock of the partnership is taken over by one of the partners at the time of dissolution, which taking over is in lieu of adjustment of his share in the assets of the quondam partnership firm. I am therefore of the view that the assessing authority as well as the appellate authority went wrong in bringing to tax the sum of Rs. 97,790 as if such a turnover represents the money consideration for the alleged transfer of property in goods from one set of partners to the other who should be deemed to have effected a sale thereof while dividing and accounting amongst themselves the

assets of the partnership. The transaction in question not involving a sale and not being one for money consideration, has been wrongly included in the net of taxation. For a greater reason it follows that the penalty imposed on the petitioner which is on the assumption that the transaction involved a sale is again erroneous. The impugned order in so far as it relates to the turnover of Rs. 97,790 is quashed and as we are not concerned with the rest of the order it will stand. The writ petition is allowed. There will be no order as to costs.