(2016) 02 MAD CK 0130

In the Madras High Court

Case No : Tax Case Appeal No. 348 of 2007

Pipelines India, Trichy — APPELLANT

Vs

The Assistant CIT, Company Circle, Trichy — RESPONDENT

Date of Decision : 08-02-2016

Acts Referred:
Income Tax Act, 1961 — Section 2(47), Section 260A, Section 45, Section 45(4), Section 47, Section 48

Citation : (2016) 02 MAD CK 0130

Hon'ble Judges : V. Ramasubramanian and N. Kirubakaran, JJ.

Bench : Division Bench

Advocate : V.S. Manoj, for the Appellant; J. Narayanaswamy, for the Respondent

Final Decision : Allowed

Judgement

V. Ramasubramanian, J.—1. This tax case appeal, filed by the assessee under Section 260A of the Income Tax Act, 1961, was admitted on the following two substantial questions of law :

"(i) Whether on the facts and circumstances of the case, the Tribunal was right in law in holding that there is a dissolution of the firm and not conversion of a firm into a company for the purpose of capital gains under Section 45(4) ? and

(ii) Whether on the facts and circumstances of the case, the Tribunal was right in law in holding that the provisions of Section 45(4) are attracted even though there was no distribution of assets ?"

2. Heard Mr.V.S. Manoj, learned counsel appearing for the appellant/ assessee and Mr.J.Narayanaswamy, learned Standing Counsel for the Department.

3. The assessee was originally a partnership firm, which came into existence in 1979-80. It comprised of four individuals as partners upto the year 1990. On 4.1.1990, a private limited company called M/s. Pipeline and Process Equipment (P) Limited was floated by the partners of the partnership firm themselves.

Thereafter, the private limited company was admitted as the fifth partner into the partnership firm. The private limited company was admittedly given a lion''s share namely 3/4th of the assets of the partnership firm. The four natural partners of the firm took the remaining 1/4th share for themselves.

4. On 30.6.1990, the four natural partners executed a release deed giving up all their rights in the partnership firm, in favour of the private limited company. As a consequence, the private limited company became the absolute owner of the partnership firm or in other words, the sole proprietor of the partnership firm. In return, for relinquishing their shares, the four natural partners were allotted shares in the private limited company.

5. For the assessment year 1991-92, the partnership firm returned an income of Rs. 8,44,620/-. The Assessing Officer came to the conclusion that there was a transfer of assets by way of distribution of capital assets on the dissolution of the firm and that therefore, the provisions of Section 45(4) were not attracted. Consequently, the Assessing Officer included the short term capital gains and made a demand.

6. The partnership firm filed a first appeal before the Commissioner of Income Tax (Appeals). The Appellate Authority concluded that there was no dissolution of the firm and hence, the provisions of Section 45(4) were attracted. The Revenue filed an appeal in ITA.No.1339/Mds/95 before the Tribunal. The Tribunal allowed the appeal on the ground that the relationship inter se between the partners had come to an end, the moment they released their shares in favour of the private limited company and that therefore, it was a clear case of dissolution of the firm and not conversion of the firm into a company. Therefore, the assessee is before us.

7. As rightly pointed out by Mr.J.Narayanaswamy, learned Standing Counsel for the Department, Section 47 that treated particular transactions as not amounting to transfer, was amended by the Finance Act, 1987 with effect from 1.4.1988. Clause (ii) of Section 47, which made ''any distribution of capital assets on the dissolution of a firm, body of individuals or other association of persons'', not to be covered by Section 45, was omitted by the Finance Act, 1987 with effect from 1.4.1988. By the very same Finance Act, 1987, Sub-Section (4) was inserted under Section 45. It reads as follows :

"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 cooperative 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 purpose 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."

8. For attracting Section 45(4), the following conditions are to be satisfied :

(i) profits and gains should arise

(ii) from the transfer of a capital asset

(iii) by way of distribution of capital assets

(iv) on the dissolution of a firm or other association of persons or body of individuals not being a company or a cooperative society and

(v) or otherwise.

9. Unless these conditions are satisfied, Section 45(4) would not get attracted. Every distribution of capital assets may not lead to the attraction of Section 45(4) unless it happens on the dissolution of a firm or other entity. Similarly, every distribution of capital assets on the dissolution of a firm may not attract Section 45(4) unless it was a case of transfer of a capital asset by way of such distribution.

10. The expression ''transfer'' is defined in Section 2(47) to mean several things. A sale, exchange or relinquishment of the asset or the extinguishment of any rights therein are all covered by the expression ''transfer''.

11. But, a Full Bench of the Karnataka High Court, in the decision in Commissioner of Income Tax Vs. Dynamic Enterprises [dated 16.9.2013 made in I.T.A. No.1414/2006] held that when a retiring partner takes only money towards the value of the share and when there is no distribution of capital asset/assets among the partners, there is no transfer of capital asset and consequently, no profits or gains are payable under Section 45(4) of the Act.

12. In the case on hand, the partners have taken equity shares in the private limited company that was inducted as the fifth partner. Therefore, whatever rights that they had in the capital assets of the firm by way of being its partners, continue to exist in the form of equity shares that they held in the private limited company. In other words, one form of ownership that they had as partners of the partnership firm, got converted into another form. Hence, this is not a case where there was either a transfer of a capital asset or the distribution of a capital asset. This aspect has been completely lost sight of by all the Authorities.

13. Therefore, the questions of law are answered in favour of the assessee/ appellant. The tax case appeal is allowed. No costs.

