(2005) 01 AP CK 0060

In the Andhra Pradesh High Court

Case No : Income-tax Tribunal Appeals No''s. 55, 58 and 63 of 2000

Sudex, Hansa Overseas Enterprises and Hansa Footwear Partnership Firm — APPELLANT

Vs

Assistant Commissioner of Gift-tax — RESPONDENT

Date of Decision : 20-01-2005

Acts Referred:

Gift Tax Act, 1958 — Section 16(1), 2, 4(1)
Income Tax Act, 1961 — Section 2(47)
Partnership Act, 1932 — Section 30, 30(2), 30(3), 30(4), 32

Citation : (2007) 210 CTR 529 : (2007) 290 ITR 511

Hon'ble Judges : M.H.S. Ansari, J;B. Seshasayana Reddy, J

Bench : Division Bench

Advocate : A.V. Krishna Kaundinya, for the Appellant; S.R. Ashok, for the Respondent

Final Decision : Allowed

Judgement

M.H.S. Ansari, J.—As the question posed for our consideration arises out of a common order of the Income Tax Appellate Tribunal ("the ITAT"), Hyderabad "B" Bench, the three appeals have been heard analogously and are being disposed of by this common judgment.

2. The above three appeals are at the instance of the assessee. The three appeals filed by the respective assessees before the Income Tax Appellate Tribunal were disposed of by a common order by the Income Tax Appellate Tribunal. It has been noticed by the Income Tax Appellate Tribunal that the common issue involved in the said three appeals relates to the assessability of the deemed gift, if any, in the property of the assessee-firms, made over to certain minor partners, in settlement of their accounts with the firms, at the time of their retirement from the said firms. The questions of law for our consideration, as framed in the memorandum of appeal by the appellant, are as under:

(1) Whether the Appellate Tribunal is right in holding that when the credit balance in the capital account of a retiring partner is settled by transferring to him certain immovable properties belonging to the firm, there is a transfer attracting the provisions of the Gift-tax Act, 1958 ?

(2) Whether the Tribunal is justified in its view that the difference between the alleged market value as assessed by the Departmental Valuation Officer and the book value of the asset at the time of retirement of minor partner to whom the asset was transferred, could be assessed as a deemed gift u/s 4(1)(a) of the Gift-tax Act, even in a situation where the property transferred to the retiring partner is only to the extent of his share in the firm ?

3. The facts giving rise to the aforesaid questions, briefly stated, are as under. The assessee-firms were having certain minor partners admitted to the benefits of the partnership. During the relevant year in question, the minor partners withdrew from the said firms. At that time, the credit balance in their capital accounts was settled by relinquishing the rights over certain immovable properties of the firm in favour of the retiring minors at the book values of those properties, as per accounts of the firms. The Assessing Officer was of the view that the difference between the market value of the properties, rights over which were relinquished in favour of the retiring minor partners, and the book values at which the same were transferred to those minors, constituted deemed gifts by the partners. Proceedings were initiated for assessment of such deemed gift to tax by resort to the provisions u/s 16(1) of the Gift-tax Act. The assessee filed a nil return contending, inter alia, that there was no deemed gift, since the value of the property at which it was transferred to the retiring partners was the same as mentioned in the books of account. However, the Assessing Officer did not agree with this contention of the assessee and treated the difference between the market value and the purchase price as deemed gift in favour of the minors who withdrew from the partnership. Being aggrieved, the assessee preferred appeals against the said gift-tax assessments contending before the Commissioner (Appeals), inter alia, that the properties of the firms were made over to the retiring partners at their book values in settlement of their capital accounts, and there was no element of transfer much less gift in the said transaction.

4. The learned Commissioner (CGT) being of the view that under the Partnership Act, minors cannot be taken as partners, examined the matter in the light of Sections 30 and 32 of the Indian Partnership Act, 1932, and held that the case law applicable to the retirement of partners is not applicable to the minor withdrawing from the firm as he does not retire as a partner. It was further held that there was no dissolution of partnership, but only a decision was taken by the adult partners to allot some immovable properties to "the minors who had been earlier admitted to the benefits of partnership, in lieu of their credit balance in the capital account and the profit accrued up to the date of their withdrawal from the partnership". After observing that the allotment of the properties has been made subject to the further condition that if subsequently it was found that the

capital balance and accrued profit were not adequate to meet the book value of those properties transferred to them, then the balance would be recoverable, the learned Commissioner (CGT) held:

... This narration in the dissolution deed clearly negatives the contention of the learned Authorised Representative that the properties had been transferred in consideration of minors'' proportionate right over the property of the firm and therefore, the consideration was adequate.

5. The respective assessees, being aggrieved, carried the matter in appeal to the Income Tax Appellate Tribunal.

6. The learned Income Tax Appellate Tribunal found no merit in the contention of the assessee that there was no transfer involved since there was mere settlement of capital account of the retiring partners by adjustment of the asset account. The learned Income Tax Appellate Tribunal upheld the conclusions as also the reasons given in support thereof by the learned Commissioner (CGT). In addition, the learned Income Tax Appellate Tribunal referred to the definition in Clause (xxiv) of Section 2 of the Gift-tax Act and in particular, Sub-clause (d) thereof which reads as under.

any transaction entered into by any person with intent thereby to diminish directly or indirectly the value of his own property and to increase the value of the property of any other person.

7. The learned Income Tax Appellate Tribunal was of the view that the instant case is one of transfer for the reason that "the value of the property made over to the retiring partner diminished in the hands of the firm, and resulted in consequent increase in the said value in the hands of the retiring partner. Even in that view of the matter, the transaction in question is a transfer".

8. The answer to the questions, as posed above, is thus dependent upon the correctness of the conclusions arrived at by the learned Commissioner (CGT) as upheld by the learned Income Tax Appellate Tribunal.

9. Mr. Kaundinya, learned Counsel for the appellant-assessee has reiterated the contentions advanced before the learned Income Tax Appellate Tribunal and also relied upon certain judgments, reference to which shall be made at the appropriate stage.

10. Mr. S.R. Ashok, learned senior standing counsel for the Revenue, sought to sustain the orders of the tax authorities and the learned Income Tax Appellate Tribunal on the grounds and for the reasons stated therein.

11. Before we deal with the rival contentions, it would be appropriate to make certain observations on the basis of the well-settled position in law with regard to the partnership firm and the rights of the partners with respect to the assets of the firm.

12. It is by now well-settled that the partnership firm under the Indian

Partnership Act, 1932, is not a distinct legal entity apart from the partners constituting it. A firm has no separate rights of its own in the partnership assets. In law, any reference to the firm''s property or firm''s assets is in substance the property or assets in which all the partners have a joint or common interest. It is not the firm that has any separate rights of its own in the partnership assets but it is the partners who own jointly, in common, the assets of the partnership. The consequence of distribution, division or allotment of assets to the partners which flows upon dissolution of the firm, it was held, is nothing but a mutual adjustment of rights between the partners and there is no question of extinguishment of the firm''s rights in the partnership assets, amounting to a transfer of assets within the meaning of Section 2(47) of the Income Tax Act See Malabar Fisheries Co. Vs. Commissioner of Income Tax, Kerala, .

13. The position in law is the same in the context of the Gift-tax Act, whether it be a case of retirement of a partner or dissolution of the firm. It is so held in the judgments, to which, we shall presently refer.

14. In The Commissioner of Gift Tax, Trivandrum Vs. T.M. Louiz, , a three-judge Bench of the Supreme Court held as under (headnote):

When a partner retires from a partnership, the partnership continues. The assets and the goodwill of the firm continue to remain the assets and the goodwill of the firm. All that the retiring partner gets is the value of his share in the partnership assets less its liabilities. It cannot, in such circumstances, be held assuming that the retiring partner received less than what was his due, that the difference was something that he had transferred to the continuing partners within the meaning of ''transfer of property'' for the purposes of the Gift-tax Act, 1958, or that there was a gift liable to gift-tax.

15. In Sri Jagatram Ahuja Vs. The Commissioner of Gift Tax, Hyderabad, also, a judgment of a three-judge Bench of the Supreme Court, arising out of the Gift-tax Act, the question for consideration was whether release by one of the partners of the firm of his rights in the assets of the firm for a consideration which was less than the market value of the assets did not amount to a gift within the meaning of the Gift-tax Act. The question was answered in the affirmative and in favour of the assessee. The apex court, in coming to the aforesaid conclusion, noticed the definition of "gift" and "transfer of property" in Section 2 of the Gift-tax Act and held that in a case of adjustment or distribution of assets of the firm in proportion to the share of the partners on its dissolution, there is no element of transfer of property involved. Reference was made in that case to Malabar Fisheries Co. Vs. Commissioner of Income Tax, Kerala, . Reliance was placed upon an earlier judgment of the Supreme Court in The Commissioner of Gift Tax, Madras Vs. N.S. Getty Chettiar, wherein it was held that in the partition of family properties, in a Hindu joint family, by allotting a greater share to the other members of the coparcenary than that to which they were entitled, the assessee would not be held to have made a gift. It was further held in that case that the partition did not effect any transfer as generally understood in law

and did not, therefore, fall within the definition of gift in Section 2(xii) of the Gift-tax Act. It was further held that such partition was not a transfer of property within the meaning of Section 2(xvvi) and not a "transaction" within the meaning of Section 2(xiiv)(d) of the Gift-tax Act. The Supreme Court in Sri Jagatram Ahuja Vs. The Commissioner of Gift Tax, Hyderabad, was of the view that the principles stated in The Commissioner of Gift Tax, Madras Vs. N.S. Getty Chettiar, equally apply to a case of allotment or adjustment of the properties among the partners upon dissolution of a firm.

16. In B.T. Patil and Sons Vs. Commissioner of Gift Tax, Karnataka, also, a three-judge Bench judgment, relied upon by learned Counsel for the Revenue, the Supreme Court drew a distinction between a case of dissolution of firm and retirement of a partner from the firm on the one hand and to a case on the other hand, when, during the subsistence of a partnership, an asset of the partnership becomes the asset of only one of the partners thereof. After extracting a relevant passage from its judgment in Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat, it opined thus (page 591):

In our view, when there is a dissolution of partnership or a partner retires and obtains in lieu of his interest in the firm an asset of the firm, no transfer is involved for the reason set out in the passage quoted above. But the position is very different, when, during the subsistence of a partnership, an asset of the partnership becomes the asset of only one of the partners thereof; there is, in such a case, a transfer of that asset by the partnership to the individual partner. Where such transfer is for less than the value of that asset, there is a deemed gift to the extent of the difference under the provisions of Section 4(1)(a) of the Gift-tax Act, 1958.

(emphasis supplied)

17. Reliance was placed by learned Counsel for the Revenue upon the statements in the latter part of the above passage on the ground that the partnership in the case on hand is subsisting. This argument is made overlooking the underlined portion of the statements, perhaps, in tune with the contention of the Revenue authorities that a minor is not a partner but is only entitled to the benefits of partnership.

18. B.T. Patil and Sons Vs. Commissioner of Gift Tax, Karnataka, was a case where certain items of machinery were allotted to the partners and their accounts were debited with the consideration charged therefor. The partners thereafter floated another partnership and brought in the said machinery as their capital contribution thereto. This new firm sold the machinery to another concern. On those facts, the Gift-tax Officer held that the assessee had made a gift of the machinery to its partners, and the assessee was charged gift-tax. The High Court held that the allotment or distribution of an asset, or some of the assets, of a firm by the firm to a partner or partners during its subsistence so as to enable such partner to hold the assets in his or their individual capacity was a

transfer of property and not an adjustment of capital.

19. The Supreme Court upheld that view. That case is distinguishable on the facts of the case on hand. In the case before the Supreme Court, there was neither retirement of any partner nor dissolution of the firm. The case on hand is not one where during the subsistence of partnership any asset has been transferred to a partner. The instant case is one where on the severance of relationship, an asset has been allotted to the retiring partner in lieu of his share in the capital and profits of the firm.

20. As already noticed, the Revenue authorities, in the case on hand, have taken the stand that the case law applicable to partners is not applicable to the case of a minor withdrawing from the benefits of partnership. Let us, therefore, consider the correctness of the said conclusions. Section 30 of the Indian Partnership Act, 1932, to the extent relevant, is extracted hereunder:

30. Minors admitted to the benefits of partnership.--(1) A person who is a minor according to the law to which he is subject may not be a partner in a firm, but, with the consent of all the partners for the time being, he may be admitted to the benefits of partnership.

(2) Such minor has a right to such share of the property and of the profits of the firm as may be agreed upon and he may have access to and inspect and copy any of the accounts of the firm.

(3) Such minor''s share is liable for the acts of the firm, but the minor is not personally liable for any such act.

(4) Such minor may not sue the partners for an account or payment of his share of the property or profits of the firm, save when severing his connection with the firm, and in such case the amount of his share shall be determined by a valuation made as far as possible in accordance with the rules contained in Section 48:

Provided that all the partners acting together or any partner entitled to dissolve the firm upon notice to other partners may elect in such suit to dissolve the firm, and thereupon the court shall proceed with the suit as one for dissolution and for settling accounts between the partners, and the amount of the share of the minor shall be determined along with the shares of the partners.

21. It is clear from Section 30(1) that though the minor cannot be a partner, he can be admitted to the benefits of partnership; the existence of a partnership is postulated u/s 30 of the Partnership Act. Sub-sections (2) and (3) thereof describe the rights and liabilities of a minor admitted to the benefits of partnership. By virtue of Sub-section (2) of Section 30, a minor has been conferred a right to "such share of the property and if the profits of the firm as may be agreed upon". Under Sub-section (3), such share of the minor can be made liable for losses though the minor cannot be held personally liable for the losses. Sub-section (4) enables a minor to sever his connection with the firm and

if he does so, the amount of his share has to be determined by a valuation made, as far as possible, in accordance with the rules contained in Section 48. Thus, for settlement of the accounts of a minor on his retirement rather severance of connection from the firm, the provisions in Section 48 have to be generally followed to the extent possible.

22. Section 48 of the Partnership Act provides for the mode of settlement of accounts between the partners. It prescribes the sequences in which the various outgoings are to be applied and the residue remaining has to be divided between the partners. To the extent relevant, Section 48 is extracted hereunder:

48. Mode of settlement of accounts between partners.

(b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:

(i) in paying the debts of the firm to third parties ; (ii) in paying to each partner rateably what is due to him from the firm for advances as distinguished from capital;

(iii) in paying to each partner rateably what is due to him on account of capital; and

(iv) the residue, if any, shall be divided among the partners, in the proportions in which they were entitled to share profits.

23. The distribution of surplus (residue) is for the adjustment of rights of partners in the assets of the partnership. As already noticed from the judgments cited supra, the allotment or distribution of an asset upon retirement of a partner or upon dissolution of the firm in proportion to the share in the firm is an adjustment of rights of partners in the assets of the partnership, and the same, it was held, does not amount to transfer and does not fall within the definition of gift.

24. Sub-section (4) of Section 30 of the Partnership Act, as already noticed, imposes a disability on the minor to sue the partners for accounts or payment of the share of the property, or profits of the firm, save when severing his connection with the firm. This Sub-section (4), however, enables a minor to sever his connection with the firm and if he does so, the amount of his share has to be determined in accordance with the rules contained in Section 48. In terms of Sub-section (2) of Section 30, a minor has been conferred a right to a "share of the property" and of the "profits of the firm". Thus, when a minor severs his connection with the firm, he is entitled to a share in the assets of the partnership. It is nobody''s case that a minor admitted to the benefits of partnership has no share in the assets of the firm. It is settled position in law that the assets of the firm would include the property which is brought into the partnership by the partners when it is formed, or which may be acquired in the course of business, becomes the property of the partnership and a partner is,

subject to any special agreement between the partners, entitled, upon retirement or dissolution, to a share in the money representing the value of the property. In other words, when a property of the firm is allotted to a minor in lieu of the minor''s proportionate rights over the property of the firm, the same would be in satisfaction of the claim of the minor to his share in the value of the residue determined in terms of Section 48. Thus, on settlement of accounts, capital and profit due to a minor on his severance, if a property of the firm is allotted to the minor in lieu of his share and profits of the firm, the same would be but a mutual adjustment of his rights in the firm''s property and no question of extinguishment of the rights in the partnership assets amounting to a transfer of assets would arise.

25. In our view, the principles stated in The Commissioner of Gift Tax, Madras Vs. N.S. Getty Chettiar, which have been held to apply to a case of allotment or adjustment of properties among the partners, would equally apply to a minor, admitted to the benefits of partnership, upon severance of his connection with the firm.

26. As regards the contention of the Revenue that the narration in the dissolution deed refers to a condition that the capital balance and accrued profit if not adequate to meet the book value of the property transferred to the minor, then the balance would be recoverable, in our view, the said condition is akin to a provision of "owelty" in the case of partition. Providing for such a condition in the dissolution deed would not militate against the principles stated in The Commissioner of Gift Tax, Madras Vs. N.S. Getty Chettiar, .

27. For the reasons aforestated, we hold that there is no transfer within the meaning of Clause (xxiv) of Section 2 of the Gift-tax Act, nor is there a gift under the Gift-tax Act, in a case, as the one on hand, where property is transferred to the minor on his severance from the firm in settlement of his accounts with the firm. We have not gone into the question whether there has been dissolution of the firm as no question has been framed in relation thereto. We have also not gone into the question of the valuation of the property in question as that was neither raised nor disputed before us.

28. Accordingly, the two questions, as framed above, are answered in the negative, i.e., in favour of the assessee and against the Revenue.

29. In the result, the three appeals are accordingly allowed setting aside the orders of the Income Tax Appellate Tribunal and deleting the tax levied by the assessing authority. No order as to costs.

