IN THE HIGH COURT FOR THE STATE OF TELANGANA: HYDERABAD

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INCOME TAX TRIBUNAL APPEAL No.352 of 2012

Between:
Smt. Girija Reddy P.

Appellant

VERSUS

Income Tax Officer.

Respondent

JUDGMENT PRONOUNCED ON: 04.04.2024

THE HON'BLE SRI JUSTICE P.SAM KOSHY

AND

THE HON'BLE SRI JUSTICE N.TUKARAMJI

1. Whether Reporters of Local newspapers may be allowed to see the Judgments? : Yes

2. Whether the copies of judgment may be marked to Law Reporters/Journals? : Yes

3. Whether His Lordship wishes to see the fair copy of the Judgment? : **Yes**

P.SAM KOSHY, J

*** THE HON'BLE SRI JUSTICE P.SAM KOSHY**

AND

THE HON'BLE SRI JUSTICE N. TUKARAMJI

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! Counsel for Appellant(s) : Mr. C.V. Narsimham

^Counsel for the Respondent(s) : Mr. Vijhay K. Punna

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> HEAD NOTE:

? Cases referred

1) [2022] 449 I.T.R. 439 (S.C.)
2) [2023] 454 I.T.R. 426 (S.C.)
3) [2012] 349 I.T.R. 423
4) (1971) 79 ITR 594 (SC)
5) (1968) 68 ITR 240 (SC)
6) (1971) 79 ITR 594 (SC)
7) (1983) 141 ITR 674 (AP)
8) (1973) 91 ITR 393 (Guj)
09) (1988) 171 ITR 128 (AP)
10) (1973) 91 ITR 393 (Guj)
11) (1987) 165 ITR 166 (SC)
12) (1983) 141 ITR 674 (AP)

THE HONOURABLE SRI JUSTICE P. SAM KOSHY

AND

THE HONOURABLE SRI JUSTICE N. TUKARAMJI

Income Tax Tribunal Appeal No.352 of 2012

JUDGMENT: *(per the Hon'ble Sri Justice P. Sam Koshy)*

The instant is an appeal preferred by the appellant under Section 260-A of the Income Tax Act, 1961 assailing the order passed by the Income Tax Appellate Tribunal (for short, 'the Tribunal') in I.T.A.No.297/Hyd/2012, dated 25.05.2012 (for short, 'the impugned order').

2. Heard Mr. C.V. Narsimham, learned counsel for the appellant and Mr.Vijhay K. Punna, learned Senior Standing Counsel for the respondent - Department.

3. *Vide* the impugned order, the Tribunal partly allowed the appeal and dismissed the stay application filed by the appellant.

4. The brief facts of the case are that the appellant herein was a partner in the firm, viz., M/s.Montage Manufacturers. The appellant stood retired from the said firm w.e.f. 26.12.2007. While retiring from the said firm, the appellant received a sum of ₹.8,22,17,952/- towards her share of capital gain of the firm. However, the respondent-Department held that the right of the appellant in the firm is a capital

asset and extinguishment of the right in the said firm stands transferred, and therefore, the receipt against the capital asset is taxable under Section 45 of the Act.

5. Alleging that the appellant has received an amount of ₹.8,2217,952/- on 26.12.2007 towards share of good will and capital, an order of assessment was passed on 27.12.2010 by the respondent-Department under Section 143(3) of the Act raising a demand of ₹.2,39,33,680/- payable by the appellant on the aforesaid amount.

6. Aggrieved by the said order, the appellant preferred an appeal before the Commissioner of Income-Tax (Appeals)-IV, Hyderabad. *Vide* order dated 31.01.2012, the Commissioner of Appeals dismissed the appeal preferred by the appellant, which was again subjected to challenge before the Income Tax Appellate Tribunal *vide* I.T.A.No.297/Hyd/2012. *Vide* order dated 25.05.2012, the appeal preferred by the appellant was partly allowed and the stay application filed by the appellant therein was dismissed.

7. Aggrieved, the present appeal has been filed by the appellant.

8. On 28.09.2012, the appeal stood admitted on the following substantial questions of law, viz.,

> *"(1) Whether the Income Tax Appellate Tribunal was correct in law in holding that the payment of the credit balance in her capital account*

with the firm received by the appellant upon retirement from the partnership firm is taxable as capital gains under the Act ?

(2) Whether the Income Tax Appellate Tribunal was correct in law in holding that the receipt of the share in value of goodwill by the appellant is taxable as capital gains under the Act ? and

(3) Whether the Income Tax Appellate Tribunal was correct in law in holding that there was transfer of capital asset by the appellant upon retirement from the partnership firm ?

9. Considering the three questions framed earlier by this Court, what is required to be answered is *Question No.1* where the substantive question is as to whether the Income Tax Appellate Tribunal was justified in holding that the payment of the credit balance in her capital account with the firm received by the appellant upon her retirement from the partnership is taxable as capital gains under the Income Tax or not.

10. Learned counsel for the appellant contended that there is in fact no transfer of capital asset by the appellant in favour of the firm, viz., M/s.Montage Manufacturers upon her retirement. He also contended that of the amount so received by the appellant is only the balance of the capital account standing in the name of the appellant. He further contended that receipt of the share value of goodwill cannot be subjected to capital gains tax as there was no transfer of goodwill to the firm by the appellant.

11. However, learned Senior Standing Counsel for the respondent-Department, was of the firm stand that the right of the appellant in the partnership firm is a capital asset and the extinguishment of the right in the said firm is in fact a transfer of the receipt against capital asset, and therefore, contended that such transfer is one which is taxable under Section 45 of the Act. He further emphasized that omission of Section 47(2) was consequent to insertion of Section 45(4) of the Act which has no relevance to the facts in the instant appeal.

12. Learned Senior Standing Counsel however relied on the decisions of the Hon'ble Apex Court in the case of **Commissioner of Income – Tax vs. Mansukh Dyeing and Printing Mills**[1] and **Principal Commissioner of Income-Tax vs. R.F. Nangrani HUF**[2].

13. At this juncture, it would be relevant to take note of the decision of a Division Bench of this High Court in **Chalasani Venkateswara Rao vs. Income-Tax Officer**[3], wherein this Court, under similar circumstances, held at paragraph Nos.19 to 22 as under :

> ***"19.*** *In* ***CIT v. Bankey Lal Vaidya***[4]*, the Supreme Court held that a partner in a firm (carrying on business of manufacturing and selling pharmaceutical products and literature relating thereto) whose assets (which included goodwill, machinery, furniture, medicines, library and copyright) were valued at Rs.2,50,000, was paid towards his half share, on the dissolution of the*

[1] [2022] 449 I.T.R. 439 (S.C.)
[2] [2023] 454 I.T.R. 426 (S.C.)
[3] [2012] 349 I.T.R. 423
[4] (1971) 79 ITR 594 (SC)

firm, a sum of ₹.1,25,000 in lieu of his share, the arrangement between the partners of the firm amounted to a distribution of the assets of the firm on dissolution. It held that there was no sale or exchange of the respondent's share in the capital assets to the other partner. The Supreme Court of India further held as follows :

> *"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 recognized method of making up the accounts of a dissolved firm. In the case the receipt of money by a partner is nothing but a receipt of his share in the distributed assets of the firm. The respondent received the money value of his share in the assets of the firm ; he did not agree to sell, exchange or transfer his share in the assets of the firm. Payment of the amount agreed to be paid to the respondent under the arrangement of his share was therefore not in consequence of any sale, exchange or transfer of assets."*

20. *The Supreme Court upheld the contention of the assessee that no part of the amount of Rs.1,25,000 received by the assessee represented capital gains and relied on* ***CIT v. Dewas Cine Corporation***[5] *referred to above. It held that adjustment of the rights of the partners in a dissolved firm by allotment of its assets is not a transfer for a price. The facts of the instant case are identical with the facts of the case in* ***CIT v. Bankey Lal Vaidya***[6]*.*

21. *In* ***CIT v. L. Raghu Kumar***[7]*, a Division Bench of the Andhra Pradesh High Court followed the judgment of the Gujarat High Court in* ***CIT v. Mohanbhai Pamabhai***[8] *and held that no transfer is involved when a retiring partner receives at the time of retirement from the firm, his share in the partnership assets either in cash or any other asset. It further held that for the purpose of section 45 of the Income-tax Act, no distinction can be drawn between*

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[5] (1968) 68 ITR 240 (SC)
6 (1971) 79 ITR 594 (SC)
7 (1983) 141 ITR 674 (AP)
8 (1973) 91 ITR 393 (Guj)

an amount received by the partner on the dissolution of the firm and that received on his retirement, since both of them stand on the same footing.

22. *In* ***CIT v. P. H. Patel***[9]*, a Division Bench of the Andhra Pradesh High Court noticed that the judgment in* ***CIT v. Mohanbhai Pamabhai***[10] *was approved by the Supreme Court in* ***Addl. CIT v. Mohanbhai Pamabhai***[11]*, and following the judgment in* ***CIT v. L. Raghu Kumar***[12] *held that when a partner retires from a partnership firm taking his share of partnership interest, no element of transfer of interest in the partnership asset by the retiring partner to the continuing partner was involved."*

14. Similarly, the Division Bench, while dealing with Sections 47(2) and 45(4) of the Act, at paragraph No.23, held as under, viz., :

"23. *In the light of the above decisions, which are binding on us, we hold that the Income-tax Appellate Tribunal was not correct in confirming the orders passed by the Commissioner of Income-tax (Appeals) and the respondent. When the appellant was paid Rs. 15 lakhs by Y. Kalyana Sundaram in full and final settlement towards his 50 per cent. share on the dissolution of the firm, there was no "transfer" as understood in law and, consequently, there cannot be tax on alleged capital gain. The appellant was correct in law in contending that the amount he received from Y. Kalyana Sundaram is towards the full and final settlement of his share and such adjustment of his right is not a "transfer" in the eye of law. It is a recognized method of making up the accounts of the dissolved firm and the receipt of money by him is nothing but a receipt of his share in the distributed asset of the firm. The appellant received the money value of his share in the assets of the firm. He did not agree to sell, exchange or transfer his share in the assets of the firm. Payment of the amount agreed to be paid to the appellant under the compromise was not in consequence of any sale, exchange or transfer of assets to Y. Kalyana Sundaram. Moreover, as rightly contended by the assessee, up to the assessment year 1987-88, section 47(ii) of the Income- tax Act,*

9 (1988) 171 ITR 128 (AP)
10 (1973) 91 ITR 393 (Guj)
11 (1987) 165 ITR 166 (SC)
12 (1983) 141 ITR 674 (AP)

1961, excluded these transactions. From assessment year 1988-89, in the case of dissolution of a firm, only the firm is taxable on capital gains on dissolution under section 45(4) of the Income-tax Act, 1961, and not the partner. Section 45(4) states as follows:

> *"45.(4) 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 co-operative 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."*

Thus, it is clear that the Legislature, even though it was aware of the above decisions, did not choose to amend the law by making the partner liable when it amended the Income-tax Act, 1961, by introducing clause (4) to section 45 by the Finance Act, 1987, with effect from April 1, 1988, and made only the firm liable. Therefore, the contention of the assessee has to be accepted and that of the Revenue is liable to be rejected."

15. Learned Senior Standing Counsel for the respondent-Department further contended that the Commissioner of Appeals in yet another case of a partner in the same firm has allowed the appeal setting aside the order passed by the Assessing Officer while allowing the appeal by relying on the aforementioned decision of the Division Bench of this Court in **Chalasani Venkateswara Rao** (3 supra), wherein it observed at paragraph Nos.4 and 5 as under, viz.,

*"**4.4.** The same was remanded to the A.O. to verify the additional grounds filed by the appellant but no reply from the A.O. Since, they are additional grounds admitted and decided by me. The appellant during the course of appeal hearings submitted that the goodwill created by the firm M/s.Montage Manufacturer through entries without incurring any cost and payment of share of the goodwill to the assessee, a retired partner, cannot be taxed for capital gains in the hands of the appellant. The appellant specifically relied on the case law of Chalasani Venkateswara Rao vs. I.T.O. wherein it was categorically held that in the fact and circumstances of the case capital gains cannot be taxed in the hands of the appellant. The appellant also submitted the provisions of Section 14 of the Indian Partnership Act, 1932 which reads "subject to contract between the partners, the property of the firm includes all property and rights and interests in property originally brought into the stock of the firm, or acquired, by purchase or otherwise by or for the firm or for the purpose and in the course of the business of the firm, and includes also the goodwill of the business. Unless the contrary intention appears, property and rights and interest in property acquired with money belonging to the firm are deemed to have been acquired for the firm.*

***5.** I have gone through the submissions of the appellant and also the observations made by the A.O. in the assessment order. After going through the above, it is noticed as per M/s.Montage Manufacturers, the goodwill was of ₹.7,95,88,699/- and not ₹.8,22,17,952/-. As per the appellants submissions and case laws relied in the case of Chalasani Venkateswara Rao vs. I.T.O., the goodwill cannot be taxed in the hands of the appellant. Therefore, I am in agreement with the submissions of the appellant and the long-term capital gains are deleted."*

16. The above order, according to learned Senior Standing Counsel for the respondent-Department, has not been subjected to further challenge in any forum. So far as the decisions relied upon by the learned Senior Standing Counsel for the respondent-Department in

R.F. Nangrani (2 supra) (also relied upon by the learned counsel for the appellant) and the decision in **Mansukh Dyeing and Printing Mills** (1 supra) are concerned, the said decisions do not lay down any law as the said decisions have been decided in an entirely different contextual backdrop unlike in the present. Therefore, the said decisions are distinguishable on facts alone.

17. Coming to the impugned order passed by the Tribunal in I.T.A.No.297/Hyd/2012, dated 25.05.2012, it is relevant at this juncture to take note of the contents of paragraph No.44 of the said judgment, which for ready reference is being reproduced as under, viz.,

> *"**44.** Thereafter the Hon'ble Court held that where accounts are taken and the partner is paid the amount standing to the credit of his capital account there would be no transfer. If, on the other hand, the partner is paid a lump-sum consideration for transferring or releasing his interest in the partnership assets to the continuing partners then there would be an element of transfer. This aspect we have already examined in the earlier paras. What we have to see now is whether the terms of the deed of retirement constitutes release of any assets of the firm in favour of the continuing partners."*

18. A plain reading of the aforesaid observations of the Tribunal would give a clear indication that the principles laid down by the Division Bench of this High Court in **Chalasani Venkateswara Rao** (3 supra) has been accepted by the Tribunal while making the aforesaid observations. However, while concluding, the Tribunal took

a different view altogether which, therefore, would not be in the opinion of this Bench, proper, legal and justified. Therefore, the respondent-Department cannot tax the amount received by the appellant upon retirement from the partnership as capital gains as there is no specific transfer of a capital asset affected when the appellant had retired from the partnership firm. So also, the finding of the Tribunal holding that the receipt of share in value of goodwill by the appellant is taxable as capital gains is not proper. Therefore, the impugned order passed by the Tribunal is unsustainable and the same deserves to be and is accordingly dismissed. The appeal stands allowed. No costs.

19. As a sequel, miscellaneous applications pending if any, shall stand closed.

P.SAM KOSHY, J

N.TUKARAMJI, J

Date: 04.04.2024

Note: **LR copy to be marked: Yes**

B/o. Ndr