HIGH COURT OF ANDHRA PRADESH

Chalasani Venkateswara Rao

v.

Income-tax Officer, Ward-IV, Vijayawada*

GODA RAGHURAM AND M.S. RAMACHANDRA RAO, JJ.
I.T.T.A NO. 70 OF 2000 †
AUGUST 3, 2012

JUDGMENT

M.S. Ramachandra Rao, J. This appeal is filed by the appellant/assessee under Section 260-A of the Income Tax Act, 1961 challenging the order dated 08-02-2000 of the Income Tax Appellate Tribunal, "B" Bench, Hyderabad in I.T.A. No. 1529/Hyd/94 for the assessment year 1989-90.

2. The appellant was a partner in a firm by name M/s. Theatre Radha, a registered firm at Vijayawada along with one Y. Kalyana Sundaram under a partnership deed dated 06-07-1976 with retrospective effect from 26-06-1976. The partnership was a partnership at will. Sri Y. Kalyana Sundaram was the owner of the site and the super structure and had brought those properties as his capital in the firm. The appellant brought in liquid cash of Rs. 3.00 lakhs. Accordingly the appellant acquired 50% interest in the site and the super-structure of the cinema theatre. At that point of time the property was valued at Rs. 6.00 lakhs. The business of the firm was carried on till 28-02-1979. Thereafter, disputes arose between the partners of the firm. The appellant sent a notice dated 07-03-1979 dissolving the partnership firm. As per Section 43 of the Partnership Act, 1932, where the partnership is at will, the firm stands dissolved by any partner giving notice in writing of his intention to dissolve the firm. Therefore, the partnership stood dissolved on 07-03-1979 which falls in the assessment year 1979-80.

3. The other partner Y. Kalyana Sundaram filed a suit O.S. No. 125 of 1979 in the Sub Court, Vijayawada for settlement of accounts which was decreed with the following directions:

"(*i*) that the first defendant be and is hereby directed to render accounts of 2nd defendant firm up to 28-02-1979 within one month from the date of this decree;

(*ii*) that in case, the first defendant fails to render accounts as per clause No.1, Commissioner be appointed for settlement of accounts of D-2 firm;

(*iii*) that the plaintiff be and is hereby directed to deposit into court the half share of the first defendant in D-2 firm within the three months from the date of this decree, and within one month on such deposit, the first defendant be and is hereby directed to transfer his interest in D-2 firm to the plaintiff by executing necessary sale deed and registering it in the name of the plaintiff at the expenses of the plaintiff as per Cl.18 of the Partnership deed dated 06-07- 1976 executed by plaintiff and 1st defendant;

(*iv*) In case, the first defendant fails to execute the sale deed in favour of the plaintiff as per Clause No. iii, the plaintiff be at a liberty to get the sale deed executed and registered through Court;

(*v*) and that the defendants do pay a sum of Rs. 21,357.75 ps. to the plaintiff towards suit costs and do bear their own costs of Rs. 7,497/- in this suit."

4. Aggrieved thereby, the appellant filed A.S. No. 2242 of 1983 in the High Court of Andhra Pradesh. On 18-07-1987, the said appeal was allowed in part with the following directions:

"(1) That the total value of the property as on 08-03-1979 be and hereby is fixed at Rs. 16,09,000/- (Rupees sixteen lakhs and nine thousand only) determining the value of the land at Rs. 300/- per square yard instead of Rs. 200/- per square yard;

(2) That the first defendant liability to account is not disputed.

(3) That the clauses (iii) and (i) of the Decree passed by the Trial Court shall be deleted and in place of clauses (iii) and (iv) of the decree, the following clauses namely "(iii) the partnership property i.e. the cinema theatre, shall be put to auction between the parties herein and (iv) If for any reason this auction fails, proceeds distributed between the parties equally subject to satisfaction of the debts outstanding if any shall be substituted as clauses (iii) and (iv) respectively.

(4) That, same as aforesaid, the decree of the trial Court shall stand confirmed in other respects, and

(5) That there be no order as to costs in this appeal."

5. Being aggrieved by the judgment and decree in A.S. No. 2242 of 1983, Y. Kalyana Sundaram filed Civil Appeal No.2742 of 1988. In the appeal, both parties filed a compromise memo and the Supreme Court disposed of the appeal by its judgment dated 08-09-1988 setting aside the judgment of the High Court and directing that the said judgment be replaced by an order in the following terms:

"1. The decree passed by the trial Court in favour of the appellant/plaintiff is restored subject to the modification in clause (iii) of the decree as regards the sum to be paid by the appellant/plaintiff to respondent/defendant No.1 in regard to the valuation of one half share of the defendant No.1 in the defendant No.2 firm as per clause 18 of the Partnership Deed as indicated hereafter and to the said extent. Upon the accounts as on 7th March 1979 being taken and the assets and liabilities being finally settled the assets will vest in the appellant/plaintiff and the liabilities as determined on taking accounts will be the responsibility of the appellant/plaintiff;

2. The appellant/plaintiff shall pay to respondent (defendant) No.1 Rs. 15.00 lakhs (Rupees fifteen lakhs only) in the manner specified hereinafter.

3. Out of the amount of Rs. 15.00 lakhs, a sum of Rs. 10.00 lakhs shall be deposited in the trial Court on or before November 5, 1988 and the remaining amount of Rs. 5.00 lakhs shall be deposited in the trial Court as early as possible but in any event before February 7, 1989. The sum of Rs. 5.00 lakhs will carry interest at the rate of 10% per annum from November 7, 1988 till the date of payment.

4. On deposit of this amount of Rs. 15.00 lakhs (and interest if any) being made in the manner indicated above, the suit of appellant/plaintiff shall stand decreed and all the assets and the liabilities of respondent No.2, firm shall vest in appellant (plaintiff) as and from 7 March 1979. Subject to the modification to the aforesaid extent the rest of the terms of the decree passed, by the trial Court will thereupon stand confirmed. The amounts deposited can be withdrawn by the 1st respondent.

5. In case, the aforementioned sum of Rs. 10.00 lakhs is not deposited latest by November 5, 1988 or the remaining amount is not deposited latest by February 7, 1989, the appeal will stand dismissed, and the order passed by the High Court will hold the field."

6. The appellant received the sum of Rs. 15.00 lakhs from Sri Y. Kalyana Sundaram in November/December 1988. According to the appellant this sum was paid towards his share in full and final settlement of the amount due to him on the dissolution of the firm in lieu of his 50% share in the firm and the assets of the partnership were taken over by Sri Y. Kalyana Sundaram.

7. The appellant as an individual filed his return for the assessment year 1989-90 on 08-04-1991 declaring a total income of Rs. 50,760/-. This income comprised of income from business at Rs. 48,864/- and other source Rs. 15,989/-. Out of this, the appellant claimed deduction under Sections 80-C and 80-L of Rs. 14,094/-. The return of the assessee was processed by the respondent under Section 143 (1) (a), on 25-10-1991.

8. Subsequently, the respondent felt that the appellant had sold away his right and title in 50% share in the Theatre Radha to his partner Y. Kalyana Sundaram in November 1988 for Rs. 15.00 lakhs, that the appellant did not admit any capital gain out of this transaction, that there is reason to believe that income

chargeable to tax has escaped assessment and issued a notice under Section 148 on 27-12-1993. The appellant filed a letter on 13-01-1994 stating that the return already filed by him on 08-04-1991 admitting a total income of Rs. 50,760/- may be treated as a return filed in response to the above notice.

9. The respondent then passed an order dated 29-03-1994 holding that under the compromise recorded in the Supreme Court mentioned above, there was a sale of an asset by the appellant to Y. Kalyana Sundaram, that the appellant's contention that it was only a case of distribution between one partner and the other on the dissolution of the firm is not correct, that there was a sale by the appellant to Y. Kalyana Sundaram for Rs. 15.00 lakhs, that the sale took effect on the date of payment of the 1st instalment i.e. 07-11-1988 to the appellant, that on payment of second and final instalment, the transfer dated back and took effect from the date of payment of the 1st instalment i.e. 07-11-1988. He therefore, computed the net long term capital gain as Rs. 3,51,050/- on the site and short term capital gain as Rs. 4,98,450/ on the assets and determined that the total income of the appellant for the assessment year 1989-90 as Rs. 9,00,260/-. He also proposed to initiate penalty proceedings under Section 271(1)(c) of the Income Tax Act 1961.

10. Aggrieved thereby, the appellant filed an appeal to the Commissioner of Income Tax (Appeals), Vijayawada. The appeal was numbered as I.T.A. No. 33/V/CIT(A)/94-95; and was dismissed on 05-08-1994.

11. Challenging the appellate order, the appellant filed I.T.A.No.1529/Hyd/94 before the Income Tax Appellate Tribunal, "B" Bench, Hyderabad.

12. Before the Tribunal, the appellant filed written submissions on 04- 02-2000 specifically contending that any arrangement between the partners relating to the distribution of the assets consequent on dissolution of the partnership is not an income and not liable to tax as capital gains. He cited CIT v. Dewas Cine Corpn. [1968] 68 ITR 240 (SC) and CIT v. Bankey Lal Vaidya [1971] 79 ITR 594 (SC) in support of his plea. He contended that consequent to the dissolution of the firm, there will be in specie distribution of assets between the partners and this could be done in any of the following ways:

(*a*) one partner takes assets and pays the other partner or

(*b*) both of them distribute the assets in their profit ratios or

(*c*) sell the assets and distribute the proceeds.

In all these transactions any surplus realized by the partner in excess of this capital balance or book balance cannot be subjected to tax as capital gains. He contended that the compromise in the Supreme Court and the consequent judgment passed by the Supreme Court is one of the ways of settlement of accounts consequent to the dissolution of the firm and there was no transfer at all involved in the transaction. He further contended that even if any transfer had occurred, it is in the assessment year 1979-80 and not in the assessment year 1989-90. He contended that a sale deed was to be executed by the appellant in favour of the other partner on the dissolution and in fact, till that day, no such sale deed is executed and registered in favour of the other partner. Lastly he also contended that up to the assessment year 1987-1988, Section 47 (ii) of the Income Tax Act, 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.

13. The I.T.A.T. did not consider the above contentions raised by the appellant before it and dismissed the appeal by order dated 08-02-2000. Aggrieved thereby the appellant has filed the above appeal under Section 260-A of the Income Tax Act, 1961.

14. Heard Sri Y. Ratnakar, learned counsel for the appellant and Sri J.V. Prasad, Senior Standing Counsel for the respondent.

15. The counsel for the appellant reiterated the contentions raised by the appellant before the I.T.A.T and cited the following decisions: *Dewas Cine Corpn.* (*supra*) and *Bankey Lal Vaidya* (*supra*), *CIT* v. *L.*

Raghu Kumar [1983] 141 ITR 674 /[1982] 11 Taxman 163 (AP) and *CIT* v. *P.H. Patel* [1988] 171 ITR 128 (AP).

16. The Standing Counsel for the respondent contended that the appellant had not raised these contentions before the I.T.A.T. but when the written submissions dated 04-02-2000 of the appellant before the I.T.A.T. were pointed out by this Court, he accepted that these points were indeed raised before the I.T.A.T. by the appellant.

17. A reading of the impugned order shows that the I.T.A.T. did not refer to the contentions raised by the appellant in his written submissions dated 04-02-2000 filed before the I.T.A.T. It also did not refer to the case law cited by the appellant in the written submissions. It merely adopted the reasoning of the C.I.T. (Appeals) and opined that the half share enjoyed by the appellant in the properties of the cinema theatre stood transferred to Y. Kalyana Sundaram only on the receipt of consideration as stipulated in the compromise decree of the Supreme Court and that for the purpose of income tax, capital gains are assessable in the assessment year 1989-90.

18. In *Dewas Cine Corpn.* (*supra*), the Supreme Court of India held as follows:

> "On dissolution of the partnership, each theatre must be deemed to be returned to the original owner, in satisfaction partially or wholly of his claim to a 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. The expression "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 is not a transfer, nor it is for price."

It further held that a partner, may, in an action for dissolution insist that the assets of the partnership be realized by sale of its assets, but where satisfaction of the claim of the partner to his share in the value of the residue determined on the footing of an actual or notional sale of property is allotted, the property so allotted to him cannot be deemed in law to be sold to him.

19. In *Bankey Lal Vaidya* (*supra*), 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 good will, machinery, furniture, medicines, library and copy right) were valued at Rs. 2,50,000/-, was paid towards his half share, on the dissolution of the firm, a sum of Rs. 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 that 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."

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 Dewas Cine Corporation (supra) 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 *Bankey Lal Vaidya* (*supra*).

20. In *L. Raghu Kumar* (*supra*), a Division Bench of the Andhra Pradesh High Court followed the judgment of the Gujarat High Court in *CIT* v. *Mohanbhai Pamabhai* [1973] 91 ITR 393 (Guj.) 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 I.T. Act, no distinction can be drawn between 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.

21. In *P.H. Patel* (*supra*), a Division Bench of the AP High Court noticed that the judgment in *Mohanbhai Pamabhai* (*supra*) was approved by the Supreme Court in *Addl. CIT* v. *Mohanbhai Pamabhai* [1987] 165 ITR 166 and following the judgment in *L. Raghukumar* (*supra*) 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.

22. In the light of the above decisions, which are binding on us, we hold that the I.T.A.T. was not correct in confirming the orders passed by the C.I.T. (Appeals) and the respondent. When the appellant was paid Rs. 15.00 lakhs by Y. Kalyana Sundaram in full and final settlement towards his 50% 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 share, exchange or transfer of assets to Y. Kalyana Sundaram. Moreover , as rightly contended by the assessee, up to the assessment year 1987-1988, Section 47 (ii) of the Income Tax Act, 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. S.45(4) states as follows:

> "S.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 I.T Act,1961 by introducing clause (4) to s.45 by the Finance Act,1987 w.e.f 1.4.1988 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.

23. In this view of the matter, this appeal is allowed and the order of the I.T.A.T., confirming the orders of the C.I.T (Appeals) and the respondent is set aside. No costs.