IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD "B " BENCH, HYDERABAD

BEFORE SHRI B. RAMAKOTAIAH, ACCOUNTANT MEMBER AND SHRI SAKTIJIT DEY, JUDICIAL MEMBER

ITA No.1200/Hyd/2010
Assessment Year 2006-07.

The ACIT, Cir-16(2), Hyderabad.	-v-	Sri N. Prasad, Executive Chairman Secunderabad. **PAN:ABKPN 3078N**
(Appellant)		(Respondent)

Appellant by Shri SolgyJose T. Kottaram
Respondent by Shri Y.R. Rao

Date of Hearing 28-11-2013
Date of pronouncement 27-01-2014

ORDER

PER SAKTIJIT DEY, J.M:

This appeal filed by the department is directed against the order dated 16-6-2010 of CIT (A)-V, Hyderabad passed in ITA No.292/DC-16(2)/CIT(A)-V/2008-09 pertaining to assessment year 2006-07.

2. The only issue arising for consideration in the present appeal is whether the CIT (A) was correct in deleting the addition of Rs.25 lakhs by holding that there is no transfer within the meaning of sec. 2(47) of the Act.

3. Briefly the facts are, the assessee is an individual. For the impugned assessment year the assessee filed his return of income

on 31-10-2006 declaring income of Rs.8,54,47,144/- During the scrutiny assessment proceeding it came to the notice of the Assessing Officer that the assessee during the previous year had retired as a partner from the partnership firm M/s Square Projects Associates on 20-4-2005. On retirement, the assessee apart from his share capital of Rs.1 crore had received Rs.25 lakhs surplus from the partnership firm. This surplus of Rs.25 lakhs was not offered for taxation. When queried by the Assessing Officer the assessee relying upon a decision of Hon'ble Supreme Court in case of CIT vs. R. Lingamallu Raghu Kumar (247 ITR 801) submitted that the amount is not taxable as there is no transfer. The Assessing Officer however rejected the contention of the assessee by holding that surplus received by assessee from the firm is nothing but goodwill paid to him for leaving the firm. The goodwill is taxable under the head capital gains income. He further held that the decision relied upon by the assessee being prior to the amendment of sec. 55(2) it is not applicable. Accordingly, the Assessing Officer by treating the cost of acquisition as nil treated the amount of Rs.25 lakhs as the short term capital gain for the year.

4. Being aggrieved of the assessment order so passed the assessee preferred an appeal before the CIT (A). The CIT (A) relying upon the judgment of the Hon'ble Supreme Court in case of CIT vs. R. Lingamallu Raghu Kumar (247 ITR 801) deleted the addition made by the Assessing Officer holding as under:-

> "**5.4. From the above judgment it is clear that the aforementioned retirement of partner does not tantamount to transfer within the meaning of section 2(47) of the Act. Moreover, the Assessing Officer has only presumed that the goodwill of the firm has been**

transferred in part to the appellant. There is no basis for such a conclusion. Further, in the case of Purayannur Industries (2010) 188 Taxman 34 (Kochi), the Hon'ble Income-tax Appellate Tribunal had held in recent judgment that on allocation of properties and goodwill to the account of the retiring partner, there is no taxability of the surplus in the hands of the retiring partner. In fact, the Income-tax Appellate Tribunal even went to the extent of stating that if a new firm is constituted by the remaining partners on the next day f the retirement of the old partner, it would still not amount to dissolution of the earlier firm and there would be no taxability.

5.5. Keeping in view of the aforementioned facts, circumstances and judgments, I hold that the surplus receipt by the retiring partner i.e., appellant is not taxable in his hands as it does not amount to transfer within the meaning of the section 2(47). Therefore, the addition made by the Assessing Officer is ordered to be deleted."

5. The learned DR submitted that since the assessee received the excess consideration of Rs.25 lakhs towards transfer of goodwill, the Assessing Officer has rightly taxed it as short term capital gain. He further submitted that as goodwill is a capital asset, any consideration received towards transfer of goodwill is chargeable to capital gain tax. Therefore, CIT (A) was not correct in deleting the addition made by relying upon a decision which is factually distinguishable.

6. The learned AR in addition to submissions made at the time of hearing also filed a written submission. The learned AR contended that as per sec. 14 of the Partnership Act Goodwill is always the

asset of the firm and there cannot be any transfer of goodwill by the assessee. The asset of the firm continues to be held by the firm itself, hence there is no provision to tax. The learned AR submitted, different High Courts as well as different benches of the Tribunal have held that excess amount by received cannot be taxed as transfer of goodwill and the excess amount received by partners on retirement or dissolution will not be liable for capital gains tax in the hands of retiring partner. In support of such contention the learned AR relied upon the following decisions.

ITO vs. Prabhuraj (6 SOT 415)

ITO vs. Amitabh Singh (16 SOT 453)

7. The learned AR submitted that a larger bench of Karnataka High Court in a judgment dated 16-9-2013 in ITA No.1414/2006 in case of CIT vs. Dynamic Enterprises held that on retirement of partner there is no transfer of capital asst. He submitted that though High Court did not answer the issue of taxation in the hands of retiring partner but the natural inference from the findings would be when there is no transfer at all the question of transferor and transferee does not arise, hence there is no occasion to tax anyone. The learned AR relied upon a decision of Smt. Durdana Khatoon vs. DCIT [93 ITD 15] wherein the Tribunal held as under:-

> **"Thus, when a partner receives her share in the assets of the partnership firm or when she receives something in excess of her share in the assets of the partnership firm, and even in a case where the partner receives a share of profit, either in the case of retirement or in a case of dissolution the same cannot be brought to tax in view of the decision of the Hon'ble Supreme Court in the case of Tribhuvandas G.Patel(supra) as well as the decision of the Hon'ble**

Supreme Court in the case of R. Lingmallu Raghukumar (supra), irrespective of the existence or deletion of section 47(ii) from the Act. As we have followed the decision of the jurisdictional High Court and the Supreme Court, we need not deal with the judgment of the Delhi and Bombay High Courts relied upon by the Revenue. Thus, we respectfully follow the judgments of the jurisdictional High Court which is upheld by the Supreme Court and hold that the amount in question cannot be brought to tax as capital gain under section 45 read with section 2(47) of the Income Tax Act as <u>there is no transfer</u>". (emphasis supplied)

8. He further relied upon a decision of the Kerala High Court in case of CIT vs. Kunnankulam Mill Board (257 ITR 544) wherein the Court held as under:-

"If a partner retires, he does not transfer any right in the immovable property in favour of the surviving partner because he has no specific right with respect to the properties of the firm. What transpires is that the right to share the income of the properties stands transferred in favour of the surviving partners, and there is no transfer of ownership of the property in such cases. In light of above and catena of decisions it could be said that when a partnership is reconstituted by adding a new partner, there is no transfer of assets within the meaning of section 45(4). (Page 48 of Paper Book)

9. The learned AR submitted that though the Tribunal in some cases such as Girija Reddy vs. ITO (52 SOT 113), Shevanti Bhai vs. ITO (4 SOT 94), Sudhakar M. Setty vs. ACIT (130 ITD 197) has held that excess amount received in lump sum by a retiring partner is taxable but in all these decisions such conclusion was reached mostly on the basis of ratio laid down by the Mumbai High Court in the following cases:-

i) CIT vs. Tribhuvandas G. Patel (115 ITR 95)

ii) CIT vs. HR Ahot (115 ITRE 255)

iii) W.A Moody vs. CIT (162 ITR 420

10. The learned AR submitted that decision of Mumbai High Court in case of Tribhuvandas G. Patel was reversed by the Apex Court in 236 ITR 515. Therefore, ratio laid down by the Mumbai High Court cannot be considered to be good law. He submitted that the jurisdictional High Court in case of CIT vs. P.H. Patel (171 ITR 128) dissented from the decision of the Mumbai High Court and held as under:-

> **" We may also refer to the decision of a Division Bench of this Court in CIT Vs. L. Raghu Kumar[1983] 141 ITR 674. In identical circumstances, this Court held that when a partner retires from the partnership, and receives his interest either in lump sum or otherwise, there is no element of transfer of interest in the partnership assets by the retiring partner to the continuing partner".**

11. He further referred to a decision of Madras High Court in case of CIT vs. Palaniappani (143 ITR 343) wherein the court held as under.

> **" Whether the retiring partner receives a lump sum consideration or whether the amount is paid to him after a general taking of accounts and after an ascertainment of his share in the net assets of the partnership as on the date of his retirement the result in terms of the legal character of the payment as well as the consequences thereof, is precisely the same".**

12. The learned AR submitted that the jurisdictional High Court in case of Chalasani Venkateswara Rao (25 Taxman com.378) has held that even in case of dissolution, w.e.f. 1988-89 only firm is taxable u/s 45(4) and not partner. He submitted that the jurisdictional High Court held that both retirement and dissolution stand on the same footing, hence as per sec. 45(4) only the firm is taxable not the partner. He submitted that when there is no provision in the Act to charge such receipt in the hands of the retiring partner, it cannot be taxed. It was submitted that even otherwise also clause 4 of retirement deed speaks of excess payment after taking into consideration the assets of the firm, hence, the excess being in relation to assets, it is not taxable even according to the decisions of Pune Bench, Mumbai Bench and Hyderabad Bench (in case of Girija Reddy)

13. We have considered the submissions of the parties and perused the materials on record. We have also carefully applied our mind to the decisions cited before us. Undisputed facts are, the assessee along with two others was carrying on business in partnership in the name and style of Square Projects Associates by virtue of a partnership deed dated 12-3-2003. Assessee vide letter dated 18-1-2005 expressed his intention of retiring from the partnership. On the basis of mutual agreement between the partners the assessee was allowed to retire from the partnership w.e.f. 20-4-2005 by virtue of a deed of retirement executed on 20-4-2005 and the other partners continued to carry on the partnership business. As per the terms of the deed of retirement, the assessee was to be paid a lump sum amount of Rs.1,25,00,000/-. The

relevant clause of the deed of retirement is extracted hereunder for convenience:-

> **"It is agreed between the parties a that after taking into account the capital investment made by the retiring partner, the goodwill of the partnership business with regard to the immovable properties purchased by the partnership firm and efforts made and time given by the retiring partner of the partnership business, the party of first part is entitled to receive a sum of Rs.1,25,00,000/- (Rupees one crore twenty five lakhs only) from the continuing partners towards full and final settlement and payment of his shares, right, title and interest and the claims of the partnership business and its assets including goodwill"**

14. While the Assessing Officer brought to tax the surplus amount of Rs.25 lakhs by treating it as a transfer of goodwill, the CIT (A) deleted the addition by holding that there is no 'transfer' when a partner received his share in the partnership business. Keeping in view the aforesaid basic facts we will now examine the legal issue whether there at all is a 'transfer' within the meaning of sec. 2(47) of the Act.

15. The Hon'ble Supreme Court in case of CIT vs. R. Lingamallu Raghu Kumar (supra) while considering the issue of excess amount received by the assessee on retirement from partnership firm whether is assessable to capital gains upheld the view of the Hon'ble A.P. High Court and that of Gujarat High Court in case of CIT vs. Mohanbhai Pamabhai (91 ITR 393) wherein it was held that there was no transfer of any asset as contemplated by the expression 'transfer' as defined in section 2(47) of IT Act. The Hon'ble Kerala High Court in case of CIT vs. Kunnikulam Mill Board

(supra) held that where there is a reconstitution of the firm consequent to the retirement of some of the partners it cannot be said that there was any transfer of any right in immovable property in favour of continuing partner. The larger bench of Karnataka High Court in case of CIT vs. Dynamic Enterprises (supra) while interpreting section 45(4) of the I T Act held that in case of distribution of capital assets on the dissolution of the firm, there is a transfer of capital asset by the firm in favour of the person and resulting profits or gains shall be chargeable to tax as the income of the firm. The larger bench further went on to hold that when cash representing the value of the share in the partnership is given to the retiring partners, no capital asset was transferred by the firm to the partner. The Hon'ble High Court held that to attract section 45(4) there should be a transfer of capital asset from the firm to the retiring partner by which the firm ceases to have any right in the property which is so transferred. In other words, its right to the property should stand extinguished and the retiring partner acquires absolute title to the property. If we apply the aforesaid tests to the facts of the present case, the assessee received a lump sum amount of Rs.1,25,000 from the partnership firm towards his share in the partnership. The partnership firm did not transfer any capital asset to the assessee to the extent by which the firm ceased to have any right in the property. In the present case, according to the Assessing Officer there is transfer of goodwill. The ITAT, Hyderabad Bench in case of Durdana Khatoon vs. ITO (supra) held that when a partner receives her/his share in the assets of the partnership firm or when he receives anything in excess of her/his share in the assets of the partnership firm and even in a case a partner receives

a share of profit either in case of retirement or in case of dissolution, the same cannot be brought to tax in view of the decision of Hon'ble Supreme Court in case Tribhuvan Das G. Patel vs. CIT (236 ITR 515) and in case of CIT vs. R. Lingamallu Raghu Kumar (supra). While doing so, the Income-tax Appellate Tribunal, Hyderabad Bench also held that in view of the decisions of Hon'ble Supreme Court, judgments of Hon'ble Delhi High Court and Hon'ble Bombay High Court (supra) are not applicable. The Hon'ble jurisdictional High Court in case of Chalasani Venkateswara Rao vs. ITO (supra) held as under:

> **"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.

16. A careful reading of the aforesaid decision of Hon'ble Jurisdictional High Court would make it clear that they approved the view of their earlier decision holding that the amount received by the partner on the dissolution of the firm or on his retirement stand on the same footing and no distinction can be drawn. The Hon'ble High Court further referred to the decision of jurisdictional High Court in case of CIT vs. P.H. Patel (171 ITR 128) wherein it was held that when a partner retires from a partnership 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. The aforesaid ratio laid down by the jurisdictional High Court clearly apply to the facts of the assessee's case.

However, we need to mention here that the Income-tax Appellate Tribunal, Hyderabad Bench in case of Smt. Girija Reddy vs. ITO (52 SOT 113) has taken a contrary view by holding that lump sum payment received by a retiring partner assigning or relinquishing his/her right in the partnership and its asset in favour of the continuing partner will attract capital gain tax. The Income-tax Appellate Tribunal, Hyderabad Bench while coming to such conclusion had mainly relied upon the following decisions.

i) CIT vs. Tribhuvan Das G. Patel (115 ITR 95)
ii) CIT vs. H.R. Aslot
iii) N.A. Moody vs. CIT (supra)
iv) Mumbai Tribunal in the case of Sudhakar M. Shetty vs. ACIT (130 ITD 197)
v) Shevanti Bhai vs. ITO (4 SOT 94)

17. However, it appears the decision of Income-tax Appellate Tribunal , Hyderabad Bench in case of Doordana Khatoon vs. ITO (supra) was not placed before the Bench. That besides the aforesaid decision of Income-tax Appellate Tribunal in case of Smt. Girija Reddy was prior to the judgment of the Hon'ble jurisdictional High Court in case of Chalasani Venkateswara Rao vs. ITO (supra). That apart, a reading of clause 4 of the deed of retirement makes it clear that the amount of Rs.1.25 cores was paid to the assessee towards his share capital and not for relinquishing or extinguishing his rights over any assets of the firm. The term 'goodwill,' in our view has been loosely used in the aforesaid clause. Furthermore, a plain reading of the clause 4 will not in any manner indicate that payment of Rs.25 lakhs was towards transfer of goodwill as

suggested by the Assessing Officer. Therefore, considering totality of facts and the circumstances of the case and applying the ratio laid down by the Hon'ble jurisdictional High Court in the case of Chalasani Venkatesara Rao (supra), which is binding on us, we are of the view that the order passed by the CIT (A) needs to be upheld. Accordingly, we dismiss the grounds raised by the department.

18. In the result, the appeal filed by the department stands dismissed.

Order pronounced in the court on 27-01-2014.

Sd/-	Sd/-
(B. RAMAKOTAIAH)	(SAKTIJIT DEY)
ACCOUNTANT MEMBER	JUDICIAL MEMBER

Hyderabad,
Dated the 27th January, 2014.
Jmr*

Copy to:-

1) *ACIT, Cir-16(2), Aayakar Bhavan, Hyderabad.*
2) *Sri N. Prasad, Executive Chariman, Matrix Laboratories Limited, 5th Floor, Alexander Road, Secunderabad.*
3) *CIT(A)-V, Hyderabad.*
4) *CIT (A) –IV, Hyderabad.*
5) *The Departmental Representative, I.T.A.T., Hyderabad.*