No capital gains tax liability on the firm under section 45(4), in case of retirement of its partner

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- By S.K.Tyagi

As is well-known in income-tax circles, there continues to be a lot of controversy about the interpretation of the provisions of section 45(4) of the Income-Tax Act, 1961 (the Act). Under section 45(4) of the Act, capital gains tax is sought to be charged on a firm in case of transfer of a capital asset and distribution of capital assets, on the dissolution of the firm or otherwise. The retirement of a partner from the firm is sought to be covered under the scope of the term "otherwise", under the provisions of section 45(4) of the Act.

Recently, an Opinion was sought by a firm whether capital gains liability will arise in its hands in the event of the retirement of two of its partners from the firm. As the issue on which the Opinion was sought is not free from controversy, all the relevant aspects relating to the aforesaid issue were examined in detail.

In other words, the Opinion sought was whether the firm, in question, will be liable to pay capital gains tax under section 45(4) of the Act, as a result of the proposed retirement of two of its partners.

In order to answer the aforesaid query, first of all it will be necessary to refer to the provisions of section 45(4) of the Act. For the sake of ready reference, section 45(4) of the Act, is reproduced as follows :

Capital gains.

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 purposes 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.*

From the aforesaid provisions of section 45(4), it is quite clear that there are two primary requirements for the application of section 45(4) in a given situation, viz :

(i) There should be a transfer of a capital asset, and

(ii) There should be distribution of capital assets on the dissolution of a firm or otherwise.

In view of the aforesaid reasons, in the present context, it will also be necessary to refer to the definition of the word '*transfer*', as defined under section 2(47) of the Act. For the sake of ready reference, section 2(47) of the Act, is reproduced as follows :

Definitions.

2. *In this Act, unless the context otherwise requires,—*

(47) "transfer", in relation to a capital asset, includes,—

(i) the sale, exchange or relinquishment of the asset ; or

(ii) the extinguishment of any rights therein ; or

(iii) the compulsory acquisition thereof under any law ; or

(iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment ; or

(iva) the maturity or redemption of a zero coupon bond; or

(v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882) ; or

(vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

Explanation 1.—For the purposes of sub-clauses (v) and (vi), "immovable property" shall have the same meaning as in clause (d) of section 269UA.

Explanation 2.—For the removal of doubts, it is hereby clarified that "transfer" includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterised

as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India;

Keeping in view the aforesaid aspects, for the purpose of the Opinion sought, it will be necessary to discuss the following issues :

(i) The nature of relationship between a partnership firm and its partners, in regard to the assets of the partnership firm under the Indian Partnership Act, 1932.

(ii) On the dissolution of a firm or on the retirement of a partner from the firm, there will not be a transfer of the assets of the firm.

(iii) In the absence of the amendment of section 2(47) of the Act, there will be no transfer of assets in the case of the dissolution of a firm or retirement of a partner from the firm.

(iv) The judgement of Panaji Bench of the Bombay High Court, in the case of *CIT Vs A.N.Naik Associates*, does not lay down the correct position of law.

(v) The correct position of law, as laid down by the later judgement of the Bombay High Court in the case of *Prashant S.Joshi Vs ITO* and also some other High Courts.

All the aforesaid issues may be discussed, in detail, as follows :

1. **The nature of relationship between a partnership firm and its partners, in regard to the assets of the partnership firm under the Indian Partnership Act, 1932.**

   In this context, section 4 of the Indian Partnership Act, 1932 (Partnership Act, for short), is very relevant. For the sake of ready reference, the same is reproduced as follows :

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   4. ***Nature of partnership***

   'Partnership' is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

   Persons who have entered into partnership with one another are called individually 'partners' and collectively 'a firm' and the name under which their business is carried on is called the 'firm name'.

   From the aforesaid section 4 of the Partnership Act, in the first place it may be seen that it contains three elements, viz :

   (i) There must be an agreement entered into by all the persons concerned ;

   (ii) The agreement must be to share the profits of a business; and

(iii) The business must be carried on by all or any of the persons concerned, acting for all.

Besides, from the aforesaid definition of Partnership, etc, it is also clear that the partners of a firm are collectively called '*a firm'* . It is also relevant here to state that under the general law, a firm is not a legal entity.

In the present context, the judgement of the Apex Court, in the case of *N. Khadervali Saheb Vs N. Gudu Sahib (Decd) [2003] 261 ITR 1 (SC)* is very relevant.

It was held in this case that a firm is not an independent entity. It is only a compendious name given to the partnership for convenience and the partners are the real owners of the assets of the firm. Therefore, on dissolution of the partnership firm, the accounts are settled amongst the partners and the assets of the partnership firm are distributed amongst the partners as per the respective shares in the partnership firm. Thus, on dissolution of a partnership firm, the allotment of the assets to individual partner is not a case of transfer of any assets of a firm.

The relevant part of the aforesaid judgement, on page 3 of the Report, is reproduced as follows :

A partnership firm is not an independent legal entity, the partners are the real owners of the assets of the partnership firm. Actually the firm name is only a compendious name given to the partnership for the sake of convenience. The assets of the partnership belong to and are owned by the partners of the firm. So long as the partnership continues each partner is interested in all the assets of the partnership firm as each partner is owner of the assets to the extent of his share in the partnership. On dissolution of the partnership firm, accounts are settled amongst the partners and the assets of the partnership are distributed amongst the partners as per their respective shares in the partnership firm. Thus, on dissolution of a partnership firm, the allotment of assets to individual partner is not a case of transfer of any assets of the firm. The assets which hereinbefore belonged to each partner, will after dissolution of the firm stand allotted to the partners individually. There is no transfer or assignment of ownership in any of the assets. This is the legal consequence of distribution of assets on dissolution of a partnership firm. The distribution of assets may be done either by way of an arbitration award or by mutual settlement between the partners themselves. The document which records the settlement in this case is an award which does not require registration under section 17 of the Registration Act since the document does not transfer or assign interest in any asset.

It was, thus, held that the award did not require registration under section 17 of the Indian Registration Act, 1908, **since the document did not transfer or assign any interest in any asset.**

In the present context, the judgement of the Allahabad High Court, in the case of *CIT Vs Surendra Kumar Gupta [2004] 270 ITR 325 (All) : 191 CTR 538 (All),* is also relevant. In this case, there were two partners constituting the firm. Both the partners decided to dissolve the firm. The assets of the firm were taken by one of the partners on dissolution. The said partner offered a specified sum to the other partner which was accepted.

It was held that the aforesaid transaction did not result in any transfer of assets, as understood in common law.

In the present context, the judgement of the Apex Court, in the case of *CIT Vs Bankey Lal Vaidya (Decd) [1971] 79 ITR 594 (SC)* is also relevant. In this case, the respondent entered into a partnership with D, to carry on the business of manufacturing and selling pharmaceutical products and literature, relating thereto. On dissolution of the firm, the assets were valued and it was agreed that the assets be taken over by D and the respondent be paid his share of the value of the assets. It was held in this case that the arrangement between the partners of the firm amounted to a distribution of the assets of the firm on dissolution. There was no sale or exchange of the respondent's share in the capital assets, nor did he transfer his share in the capital assets. Therefore, there could arise no capital gains tax liability in the aforesaid transaction.

It was further held that 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.

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From the aforesaid section 4 of the Partnership Act, as well as the legal precedents, it is quite clear that on dissolution of a firm or retirement of a partner from the firm, there is no transfer of assets of the firm and accordingly, no capital gains tax liability will arise in the case of the firm.

2. On the dissolution of a firm or on the retirement of a partner from the firm, there will not be a transfer of the assets of the firm.

There are a number of judgements of the Supreme Court, as well as the High Courts, according to which when a partner retires from a firm and receives an amount in respect of his share in the

partnership, there is no transfer of interest of the partner in the assets of the firm and no part of the amount received by him would be assessable to capital gains tax under section 45 of the Act. The reason for the same is that an amount paid to a partner upon retirement, after taking accounts and upon deduction of liabilities, does not involve an element of transfer within the meaning of section 2(47) of the Act.

In support of the aforesaid stand, reliance is placed on the following legal precedents :

(i) CIT Vs Mohanbhai Pamabhai [1973] 91 ITR 393 (Guj)

It was held in this case that when a partner retires from a firm and receives an amount in respect of his share in the partnership, there is no transfer of interest of the partner in the assets of the firm and no part of the amount received by him would be assessable to capital gains tax under section 45 of the Act.

The gist of the aforesaid judgement may be stated as follows :

Section 2(47) defines "transfer" in relation to a capital asset. This definition gives an artificially extended meaning to the term by including within its scope and ambit two kinds of transactions which would not ordinarily constitute "transfer" in the accepted connotation of that word, namely, relinquishment of the capital asset and extinguishment of any rights in it. But, even in this artificially extended sense, there is no transfer of interest in the partnership assets involved when a partner retires from the partnership.

The interest of a partner in a partnership is not interest in any specific item of the partnership property. It is a right to obtain his share of profits from time to time during the subsistence of the partnership and on dissolution of the partnership or on his retirement from the partnership to get the value of his share in the net partnership assets which remain after satisfying the debts and liabilities of the partnership. When, therefore, a partner retires from a partnership and the amount of his share in the net partnership assets after deduction of liabilities and prior charges is determined on taking accounts on the footing of notional sale of the partnership assets and given to him, what he receives is his share in the partnership and not any consideration for transfer of his interest in the partnership to the continuing partners. His share in the partnership is worked out by taking accounts in the manner prescribed by the relevant provisions of the partnership law and it is this, namely, his share in the partnership which he receives in terms of money. ***There is in this transaction no element of transfer of interest in the partnership assets by the retiring partner to the continuing partners.***

The transfer of a capital asset in order to attract capital gains tax must be one as a result of which consideration is received by the assessee or accrues to the assessee. ***When a partner retires from a partnership what he receives is his share in the partnership which is worked out and realized and does not represent consideration received by him as a result of the extinguishment of his interest in the partnership assets.***

Hence, when an assessee retires from a firm and receives an amount in respect of his share in the partnership there is no transfer of interest of the assessee in the goodwill of the firm and ***no part of the amount received by him would be assessable to capital gains tax under section 45.***

(ii) *Addl CIT Vs Mohanbhai Pamabhai [1987] 165 ITR 166 (SC)*

The Gujarat High Court, in the case of *CIT Vs Mohanbhai Pamabhai [1973] 91 ITR 393 (Guj),* held that when a partner retires from the firm and receives his share of an amount calculated on the value of the net partnership assets of the firm, there was no transfer of interests of the partner in the assets of the firm and no part of the amount received by him would be assessable as capital gains under section 45 of the Act.

The Department preferred an appeal to the Supreme Court against the aforesaid judgement of the Gujarat High Court.

The Supreme Court, in view of its earlier judgement, in the case of *Sunil Siddharthbhai Vs CIT [1985] 156 ITR 509 (SC),* dismissed the appeal of the Department and thus, the aforesaid judgement of the Gujarat High court was affirmed by the Supreme Court.

(iii) *CIT Vs R.L. Raghukumar [2001] 247 ITR 801 (SC): 166 CTR 398 (SC)*

In this case, the Andhra Pradesh High Court had held that there was no transfer of any assets, as contemplated by the expression '*transfer*', as defined under section 2(47) of the Act. The High Court had placed reliance on the judgement of Gujarat High Court, in the case of *CIT Vs Mohanbhai Pamabhai [1973] 91 ITR 393 (Guj)*

It was held in the aforesaid judgement of Gujarat High Court that when a partner retires from a firm and the amount of his share in the partnership assets after deduction of liabilities and prior charges is determined on taking accounts in the manner prescribed by the partnership law, there is no element of transfer of interest in the partnership assets by the retired partner to the continuing partners and the amount received by the retiring partner is not "*capital gain*" under section 45 of the Income-Tax Act, 1961.

The Supreme Court, in view of its judgement in the case of *Addl CIT Vs Mohanbhai Pamabhai [1987] 165 ITR 166 (SC)*, which upheld the aforesaid judgement of Gujarat High Court, dismissed the appeal of the IT Department and affirmed the judgement of Andhra Pradesh High Court.

It was, thus, held that on retirement of the assessee partner from the firm, there was no element of transfer of interest in partnership assets by the retired partner to the continuing partners and the amount received by him was not assessable to capital gains.

(iv) B.T. Patil and Sons Vs CGT [2001] 247 ITR 588 (SC) : [2000] 163 CTR 363 (SC)

It was, *inter alia*, held in this case that when there is dissolution of a partnership or a partner retires and obtains in lieu of his interest in the firm, an asset of the firm, no transfer of property is involved.

(v) Jagatram Ahuja Vs CGT [2000] 246 ITR 609 (SC) : 164 CTR 1 (SC)

It was, *inter alia*, held in this case that no partner of a firm can claim exclusive or specific right in any specific asset of the property of a firm. Therefore, when the assessee partner released his rights in the assets of the firm for a specified consideration on his retirement from the firm which stood dissolved, there was merely a case of adjustment or distribution of the assets of the firm on its dissolution and accordingly, no transfer of property was involved.

In the light of the aforesaid legal precedents, it is clearly established that when there is a dissolution of a partnership or a partner retires from the firm and obtains, in lieu of his interest in the firm, an asset of the firm, no transfer of property is involved.

3. In the absence of the amendment of section 2(47) of the Act, there will be no transfer of assets in the case of the dissolution of a firm or retirement of a partner from the firm

As pointed out earlier, for the purpose of taxation of capital gains under section 45(4), two conditions are necessary, viz.:

(i) There should be a transfer of a capital asset, and

(ii) There should be distribution of capital assets on the dissolution of a firm or otherwise.

Besides, as pointed out earlier, it was held by the Gujarat High Court in the case of *CIT Vs Mohanbhai Pamabhai (1973] 91 ITR 393 (Guj)*, that even under the artificially extended definition of '*transfer*' under section 2(47) of the Act, there is no transfer of interest in the partnership assets involved when a partner retires from the partnership. The aforesaid

judgement was later on affirmed by the Supreme Court in the case of *Addl CIT Vs Mohanbhai Pamabhai [1987] 165 ITR 166 (SC)*.

In view of the aforesaid reasons, when a partner of a firm retires from the firm and receives an amount, in respect of his share in the partnership, there is no transfer of interest of the partner in the assets of the firm and accordingly, no part of the amount received by the partner would be assessable to capital gains tax under section 45 of the Act.

Therefore, in the absence of a specific provision in section 2(47) of the Act, section 45(4) can not assume a '*transfer*'. In this context, the following observations of the Supreme Court in the case of *Sunil Siddharthbhai Vs CIT [1985] 156 ITR 509 (SC),* on page 519 of the Report are relevant.

It has been held by this court in CIT Vs Dewas Cine Corporation [1968] 68 ITR 240 (SC), CIT Vs Bankey Lal Vaidya [1971] 79 ITR 594 (SC) and recently in Malabar Fisheries Co. Vs CIT [1979] 120 ITR 49 (SC) as well as by the Punjab and Haryana High Court in Kay Engineering Co. Vs CIT [1971] 82 ITR 950, the Kerala High Court in CIT Vs Nataraj Motor Service [1972] 86 ITR 109 and the Gujarat High Court in CIT Vs Mohanbhai Pamabhai [1973] 91 ITR 393, ***that when a partner retires or the partnership is dissolved, what the partner receives is his share in the partnership****. What is contemplated here is a share of the partner qua the net assets of the partnership firm. On evaluation, that share in a particular case may be realized by the receipt of only one of all the assets. What happens here is that a shared interest in all the assets of the firm is replaced by an exclusive interest in an asset of equal value.* ***That is why it has been held that there is no transfer. It is the realization of a pre-existing right.*** (Emphasis added)

The aforesaid view is also supported by the following legal precedents :

(i) CIT Vs Mohanbhai Pamabhai [1973] 91 ITR 393 (Guj)

It was held in this case that section 2(47) defines '*transfer*' in relation to a capital asset. This definition gives an artificially extended meaning to the term by including within its scope and ambit, two kinds of transactions, which would not ordinarily constitute '*transfer*' in the accepted connotation of that word, namely, relinquishment of the capital asset and extinguishment of any rights in it. But even in this artificially extended

sense, there is no transfer of interest in the partnership assets involved when a partner retires from the partnership.

(ii) Addl CIT Vs Mohanbhai Pamabhai [1987] 165 ITR 166 (SC)

In this case, the Supreme Court has affirmed the aforesaid judgement of Gujarat High Court.

Therefore, the aforesaid view of the Gujarat High Court regarding section 2(47) in relation to retirement of a partner from a firm, was fully affirmed by the Supreme Court.

(iii) CIT Vs R.L. Raghukumar [2001] 247 ITR 801 (SC) : 166 CTR 398 (SC)

It was held in this case that according to the High Court there was no transfer of any assets as contemplated by the expression '*transfer*' as defined in section 2(47) of the Act. The High Court had placed reliance on the judgement of Gujarat High Court in the case *of CIT Vs Mohanbhai Pamabhai [1973] 91 ITR 393 (Guj)*, which was later on affirmed by the Supreme Court in the case of *Addl CIT Vs Mohanbhai Pamabhai [1987] 165 ITR 166 (SC)*. Accordingly, the appeal of the I.T. Department against the order of the A.P. High Court was dismissed.

It was, thus, held that on retirement of a partner from the firm there was no element of transfer of interest in partnership assets by the retired partner to the continuing partners and the amount received by him was not assessable to capital gains.

(iv) CIT Vs Surendra Kumar Gupta [2004] 270 ITR 325 (All) : 191 CTR 538 (All)

In his case the assets of the firm were taken over by one of the two partners on dissolution of the firm, on payment of an agreed amount to the other partner.

It was held that the aforesaid transaction did not result in any transfer of asset as understood in common law.

(v) CIT Vs P.N. Panjawani (Decd) [2012] 80 DTR 200 (Karn)

In this case, also, the provisions of section 2(47) were examined, in the context of reduction of share in partnership firm on induction of new partners.

It was held that reduction of share of old partners of the firm on reconstitution of firm by inducting new partners and withdrawal of amount by old partners out of the capital contributed by new partners, did not constitute transfer in the hands of partners, making them liable to capital gains tax.

It was also held that the provisions of section 45(3) or section 45(4) were not applicable to the facts of the case.

(vi) CIT Vs Kunnamkulam Mill Board [2002] 257 ITR 544 (Ker) : 178 CTR 356 (Ker)

It was held in this case that on retirement of the partner of the firm, there is no transfer of the assets of the firm in favour of the continuing partners within the meaning of section 45(4) of the Act.

In view of the aforesaid legal precedents, it is clearly established that there is no transfer on dissolution of a firm or retirement of a partner from the firm, within the meaning of section 2(47) of the Act. Therefore, in the absence of the amendment of section 2(47) of the Act, there will be no transfer of assets in the case of the dissolution of a firm or retirement of a partner from the firm.

4. The judgement of Panaji Bench of Bombay High Court, in the case of *CIT Vs A.N. Naik Associates*, does not lay down the correct position of law.

In the present context, it will also be appropriate to refer to the judgement of Panaji Bench of the Bombay High Court in the case *of CIT Vs A.N. Naik Associates [2004] 265 ITR 346 (Bom) : 187 CTR 162 (Bom)*

It was held in this case that after the insertion of sub-sections (3) and (4) of section 45 w.e.f. 1.4.1988, the word '*otherwise*' appearing in section 45(4) of the Act, not only includes cases of dissolution, but also takes within its sweep, cases of retirement of partners even though there is no dissolution and the business is a continuing one.

The aforesaid judgement of the Bombay High Court does not lay down the correct position of law in view of a number of reasons, viz.:

(i) Prior to the introduction of section 45(4), the accepted legal position was that there was no transfer on dissolution of a firm or retirement of a partner from the firm, as held by the Supreme Court and the High Courts in a number of judgements referred to earlier, in the preceding para (2)

(ii) In the absence of the amendment of section 2(47) of the Act, there will be no transfer of assets either on dissolution of a firm or retirement of a partner from the firm, under the provisions of section 45(4) of the Act.

This position has been clearly brought out in the preceding para (3).

(iii) Besides, the Bombay High Court in its judgement appears to have overlooked the distinction between section 45(3) and section 45(4) of the Act, as is clearly laid down by the Supreme Court in the case of *Sunil Siddharthbhai Vs CIT [1985] 156 ITR 509 (SC).*

It may be specifically stated here that in view of the aforesaid judgement of the Supreme Court the retirement of a partner from a firm could not be covered under section 45(4) of the Act.

Even under the Income-Tax Act, 1961, there is a clear distinction between '*dissolution*' and '*reconstitution'* of a firm. These expressions have been separately used under the Act, in sections 189 and 187, respectively.

Therefore, the expression '*otherwise*' used in section 45(4) can not cover the reconstitution of a firm, including retirement of a partner.

(iv) The aforesaid judgement of Panaji Bench of Bombay High Court has not been followed in the later judgement of the Bombay High Court in the case of *Prashant S. Joshi Vs ITO [2010] 324 ITR 154 (Bom) : 36 DTR 227 (Bom)*

It was held in this case that *ex-facie* section 45(4) deals with a situation where there is a transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or otherwise. Evidently, on the admitted position, there is no transfer of a capital asset by way of distribution of a capital asset on the dissolution of a firm or otherwise on the facts of the case.

It was also clearly held in this case that an amount paid to a partner upon retirement, does not involve an element of transfer within the meaning of section 2(47) of the Act.

(v) Similarly, the Kerala High Court in the case of *CIT Vs Kunnamkulam Mill Board [2002] 257 ITR 544 (Ker) : 178 CTR 356 (Ker)*, has held that on retirement of a partner of the firm there is no transfer of the assets of the firm in favour of the continuing partners within the meaning of section 45(4) of the Act.

In the light of the aforesaid reasons, particularly the aforesaid judgement of Bombay High Court in the case of *Prashant S. Joshi*, the judgement of Panaji Bench of Bombay High Court in the case of *A.N. Naik Associates*, has got to be ignored, because it does not lay down the correct position of law.

5. The correct position of law, as laid down by the later judgement of Bombay High Court, in the case of *Prashant S.Joshi Vs ITO* and also some other High Courts

The correct position of law in regard to the issue under consideration has been laid down by the Bombay High Court in the case of *Prashant S. Joshi Vs ITO [2010] 324 ITR 154 (Bom) : 36 DTR 227 (Bom)*

It has been clearly laid down in this judgement that an amount paid to a partner upon retirement, after taking accounts and upon deduction of liabilities, does not involve an element of transfer within the meaning of section 2(47) of the Act. Therefore, there is no transfer of capital asset by way of a distribution of the capital assets, on the dissolution of a firm or otherwise.

The gist of the aforesaid judgement of Bombay High Court may be stated as follows :

During the subsistence of a partnership, a partner does not possess an interest in specie in any particular asset of the partnership. During the subsistence of a partnership, a partner has a right to obtain a share in profits. On a dissolution of a partnership or upon retirement, a partner is entitled to a valuation of his share in the net assets of the partnership which remain after meeting the debts and liabilities. ***An amount paid to a partner upon retirement, after taking accounts and upon deduction of liabilities does not involve an element of transfer within the meaning of section 2(47). Ex-facie sub-section (4) of section 45 deals with a situation where there is a transfer of a capital asset by way of a distribution of capital assets on the dissolution of a firm or otherwise. Evidently, on the admitted position there is no transfer of a capital asset by way of a distribution of the capital assets, on a dissolution of the firm or otherwise in the facts of this case.***

It may also be emphatically stated here that in case of a conflict between two judgements of the same High Court, the later judgement is to be preferred and followed.

In this context, the following judgements of other High Courts are also relevant :

(i) CIT Vs Kunnamkulam Mill Board [2002] 257 ITR 544 (Ker) : 178 CTR 356 (Ker)

This judgement directly relates to the interpretation of section 45(4) of the Act .

It was held in this case that ownership of the property does not change with the change in the constitution of the firm. As long as there is no change in the ownership of the properties of the firm, there is no transfer of capital asset. If a partner retires, he does

not transfer any right in the property in favour of the continuing partners. What is transferred is the right to share the income of the properties in favour of the continuing partners. Similarly, when a partnership is reconstituted, by adding a new partner, there is no transfer of asset within the meaning of section 45(4) of the Act.

It was, thus, clearly laid down in the aforesaid judgement that on retirement of the partner of the firm, there is no transfer of the assets of the firm in favour of the continuing partners within the meaning of section 45(4) of the Act. Accordingly, the questions formulated were answered against the Revenue and in favour of the assessee.

(ii) CIT Vs P.N. Panjawani (Decd) [2012] 80 DTR 200 (Karn)

It was held in this case that reduction of share of old partners of the firm on reconstitution of the firm by inducting new partners and withdrawal of amount by old partners out of capital contributed by new partners, does not constitute transfer in the hands of partners making them liable to capital gains tax.

It was also held that the provisions of section 45(3) or section 45(4) are not applicable to the facts of the case.

(iii) CIT Vs Rita Mechanical Works [2010] 46 DTR 133 (P&H)

It was held in this case that section 45(4) is not attracted to the case of conversion of partnership firm into a company.

In this case the High Court has also distinguished the judgement of Panaji Bench of Bombay High Court in the case of *CIT Vs A.N. Naik Associates [2004] 265 ITR 346 (Bom) : 187 CTR 162 (Bom)*

In the light of the aforesaid reasons, particularly the later judgement of the Bombay High Court in the case of *Prashant S. Joshi*, an amount paid to a partner upon retirement, after taking accounts and upon deduction of liabilities, does not involve an element of transfer within the meaning of section 2(47) of the Act. Therefore, there is no transfer of a capital asset, by way of distribution of the capital assets, on a dissolution of the firm or otherwise, under the provisions of section 45(4) of the Act.

6. Conclusion

In the light of the discussion in the preceding paras, it is clearly established that –

(i) In view of the provisions of section 4 of the Indian Partnership Act, 1932, as well as the legal precedents in relation thereto, on dissolution of a firm or retirement of a partner from the firm, there is no transfer of assets of the firm and accordingly, no capital gains tax liability will arise in such an eventuality, in the case of the firm.

(ii) In view of a number of judgements of the Supreme Court and the High Courts, on the dissolution of a firm or the retirement of a partner from the firm, there will not be any transfer of assets of the firm.

(iii) In the absence of the amendment of section 2(47) of the Act, there will be no transfer of assets in the case of the dissolution of a firm, or retirement of a partner from the firm.

(iv) In the light of the reasons brought out in the preceding para (4), particularly in view of the later judgement of Bombay High Court, in the case of *Prashant S.Joshi Vs ITO [2010] 324 ITR 154 (Bom) : 36 DTR 227 (Bom),* the judgement of Panaji Bench of Bombay High Court, in the case of *A.N.Naik Associates,* has got to be ignored, because it does not lay down the correct position of law.

(v) In the light of the judgement of Bombay High Court, in the aforesaid case of *Prashant S.Joshi* and the judgements of other High Courts, an amount paid to a partner on retirement, after taking accounts and upon deduction of liabilities, does not involve an element of transfer, within the meaning of section 2(47) of the Act.

Therefore, there is no transfer of capital asset, by way of distribution of capital assets, on the dissolution of the firm or on retirement of a partner from the firm, under the provisions of section 45(4) of the Act.

In view of the aforesaid reasons, there will be no capital gains tax liability in the hands of the firm, in the event of the retirement of its partner(s).

S. K. TYAGI
M.Sc., LL.B., **Advocate**
Ex-Indian Revenue Service
Income-Tax Advisor
Website: www.sktyagidt.com

Office : (020) 26133012
: (020) 40024949
Residence : (020) 40044332
E-mails : sktyagidt@airtelmail.in
: tyagi@sktyagidt.com

Flat No.2, (First Floor)
Gurudatta Avenue
Popular Heights Road
Koregaon Park
PUNE - 411 001