income-tax Officer Vs. Sita Ram Tekriwal, Huf.

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Court : Allahabad

Decided On : Sep-10-1985

Reported in : [1986]15ITD663(NULL)

Appeal No. : IT APPEAL NO. 1425 (ALL.) OF 1983 [ASSESSMENT YEAR 1973-74]

Appellant : income-tax Officer

Respondent : Sita Ram Tekriwal, Huf.

Judgement :

ORDER

Per Shri Prakash Narain, Accountant Member - The only contention in this appeal is that the AAC had erred in deleting the addition of Rs. 61,282 made under section 41(2) and Rs. 13,324 made under section 45 of the Income-tax Act, 1961 (the Act).

2. The assessee is an HUF. He was a partner in the firm of Vijai Picture Palace represented through its karta, Shri Sita Ram Tekriwal. The other partner was Shri Ram Kishan Tekriwal. The firm was running a cinema in Gorakhpur. Some dispites arose between the above two partners, as a result of which the cinema remained closed from 20-10-1971 to 30-3-1972. Subsequently, on 28-3-1972, an agreement was arrived at between the above two partners. As a result of this agreement, the firm was dissolved on the above date. It was further decided that Shri Sita Ram Tekriwal will sell his half interest in the assets of the firm to Smt. Chameli Devi wife of Shri Ram Kishan Tekriwal and Smt. Lalita Devi daughter-in-law of Shri Ram Kishan Tekriwal. The assessee was to receive a sum of Rs. 75,000 on this sale. Besides, his debit balance with the above firm was also wiped off.

3. The above arrangement was put through two different documents executed on the same date, i.e., 28-3-1982. One was deed of dissolution and the other was sale deed. We will refer to these documents again in our this order. In its books of account, the assessee debited two sums of Rs. 56,182 and Rs. 75,000 being the debit balance from Vijay Picture Place. The aggregate of the two sums being Rs. 1,31,182 was transferred by the assessee to its profit and loss account.

4. It was claimed before the ITO that the above amount was not lible to tax on the ground that it was casual income. It was submitted before him that the above amount represented the value of surrender of the rights in the firm and was entirely by goodwill that the firm had. The ITO rejected this contention. He observed that the goodwill was an intangible asset, whereas the machinery, building and stock-in-trade, etc., which were the subject of the sale were tangible assets. According to him, sale proceeds in respect of tangible assets could not be said to be exempt from tax. He

analysed the various assets, which were subject of the sale and found that they were plot of land, cinema building, another building of Vijai Engg. Works and cinema machinery and its accessories. The ITO also found that the market value of the above properties on the date of their sale was much higher. In this opinion, this was clear from the fact that the assessee was allowed to wipe out its over draft with the firm amounting Rs. 75,000. The ITO finally held that the surplus of Rs. 79,000 which he arrived at after making certain adjustments, was assessable in the hands of the assessee either as profit under section 4(2) or as capital gains under section 45. He worked out the profit under section 41(2) at Rs. 61,282 and the capital gains at Rs. 18,324. He included this amount in the assessment.

5. The assessee appealed to the AAC. The submission placed before the ITO were repeated before him. It was also argued before him that in any case, the assessee had received the above amount on distribution of assets of the firm at the time of its dissolution and, therefore, no part of the amount was taxable as capital gains in view of clause (ii) of section 47 of the Act. This clause state that nothing contained in section 45 shall apply to a transfer arising out of any distribution of capital assets on the dissolution of a firm.

6. The AAC made certain adjustments and worked out the profit accruing to the assessee only at Rs. 85,620. He further held that the above amount also was not taxable in the hands of the assessee for the following reasons :

'1. That the amount was received by the assessee on the dissolution of the firm involving no transfer attracting capital gains.

3. The assessee as a partner in the Vijai Picture had been receiving considerable and huge profit without employment of any fund or skill and the income was mainly on account of goodwill of the firm of which the assessee was 50 per cent owner and, therefore, the consideration received by the assessee represented the value of the goodwill, which was not taxable.

4. The assessee had received the above amount on distribution of the assets of the firm and the amount was not taxable in terms of section 47(ii) of the Income-tax Act, 1961.

5. That in any case, the assessee had received the above amount on account of sale of source of income, which was not taxable.'

The AAC, therefore, deleted both the additions of Rs. 61,282 and Rs. 18,324.

7. The department is now in appeal before us. The learned departmental representative supporting the order of the ITO submitted before us that the amounts received by the assessee represented the sale proceeds of various tangible assets as distinguished from the value of the goodwill and, therefore, the provisions of the sections 41(2) and 45 were attracted to the case, he referred to the decisions of the Punjab and Haryana High Court in Sukhbir Parshad v. CIT and of the Supreme Court in CIT v. Gangadhar Baijnath : [1972]86ITR19(SC) .

8. The learned counsel for the assessee, on the other hand, submitted that since the amounts had been received by the assessee as a partner on the dissolution of the firm of Vijay Picture Palace, it did not attract either section 4(2) or section 45. His

contention was that section 41(2) had no application as the assets had been sold by the firm itself and the assessee number of decided authorities. His alternate submission was that even if it could be taken that the assessee became the owner of the assets before their sale, it was only the sum of Rs. 75,000 which could be considered for determining the taxable capital gains. According to him, the sum of Rs. 56,182 which the assessee owed to the firm and which had been written off on its dissolution, could not be subjected even to capital gains.

9. We have carefully considered the submission placed before us. We will first analyse the sale deed and the dissolution deed. We will refer paragraphs 2 and 3 from the sale deed as under :

'2. Whereas, the first party was the partner in a registered partnership firm known as Vijai Picture, situated in Mohalla Purdilpur city Gorakhpur, and whereas the said firm owned the properties movable and immovable detailed and the vendor had share to the extent of one-half in the aforesaid firm and the entire assets of the aforesaid firm goodwill of Vijai Picture Palace in consideration of a sum of Rs. 75,000 (Rupees seventy-five thousand only) in the properties given below (3) in favour of vendees and endees have agreed to purchase the same. The parties are at liberty to continue the picture palace in the same name or any other name as they may like or agree from time to time.

3. So, I, Sita Ram Tekriwal, the vendor, hereby transfer by way of sale my entire profit, title and interest in the entire properties detailed below (4) and deliver possession to the vendees who have taken possession over the same. The vendees have satisfied themselves through Shri Ram Kishan Tekriwal. Who is the husband of Smt. Chameli Devi and father-in-law of Smt. Lalita Devi, the vendees about the soundness of the title of the vendor.'

The above extract from the sale deed clearly points out that the assessee had received his interest in the firm. That could have been possible only after it had been dissolved. We do not agree with the submission of the learned counsel for the assessee that the above sale could be treated as invalid or ineffective inasmuch as the assessee had sold the assets or his interest in the firm before it was dissolved.

10. We will now refer to the deed of dissolution and in particular the following paragraph from its preamble :

'Whereas both the aforesaid parties were partners in a registered partnership firm known as Vijai Picture Palace Mohalla Purdilpur, Cinema Road, Gorakhpur and whereas the said firm was dissolved the firm and understood the entire account of the business of the firm whatever liability of any kind including the Government dues, taxes, licence fees, private debts in the documents of Vijai Picture Palace, etc., due from the firm or to the firm, all those will be paid and received by party No. 1. The second party will have nothing to do with any kind of the same. The second party has sold wife of Shri Ram Krishan Tekriwal resident of Mohalla Raiganj Gorakhpur and Smt. Lalita Devi wife of Indra Kumar Tekriwal and daughter-in-law of Shri Ram Krishan Tekriwal aforesaid.

It was submitted by the learned counsel for the assessee that before the firm was dissolved, the assessee had sold its entire share in the assets of the firm to the two ladies. His contention, therefore, was that the sale had taken placed before the firm

was actually dissolved. From this, he drew a legal conclusion that since a partner could not say which particular asset in a firm was in his ownership, he could not effect its sale also. In this High Court in CIT v. Bhupinder Singh Atwal : [1981]128ITR67(Cal) . The Court referred to the decision of the Supreme Court in A. Narayanappa v. Bhaskara Krishnappa : [1966]3SCR400 and CIT v. Dewas Cine Corpn. : [1968]68ITR240(SC) . In these cases, it was held that during the subsistence of the partnership, no partner could deal with the portion of the property on his own nor could be assign his interest in a specific item of the partnership property to anyone. The submission of the learned counsel for the assessee, therefore, was that sale of the assets was by the firm and had taken placed before the firm was dissolved. He also emphasised the since the fact of sale was incorporated in the deed of dissolution quoted above, it supported the above theory. According to him, once this fact was accepted, them the only conclusion that could be drawn was that the receipt of the amount by the assessee was as a partner in the firm which did not attract either section 41(2) or section 45.

11. We do not subscriber to the view held by the learner counsel for the assessee. Our reading of the above two deeds leads us to a different reference. In our opinion, the dissolution of the firm had preceded the male of assessees interest to the ladies. Unless the assessee had received its share or the interest in the assets of the property, it could not sell it. That is a legal proposition and cannot be disputed. The ownership of the assets must precede their sale. Merely because the fact of the sale is also recorded in the dissolution deed, is no ground to hold that the sale had preceded the dissolution. Since both these documents were executed on the same date in a pre-planned manner, there was nothing surprising to incorporate almost similar facts in both the documents. While the dissolution deed incorporated the fact of sale the sale deed also referred to the assessees interest in the assets of the firm. Our finding, therefore, is that there was first the dissolution of the firm. It was followed by the receipt of the assets by the assessee falling to its share through its karta, which was then followed by the sale of the those assets to the family members of Shri Ram Krishan Tekriwal, the other partner. This completed the arrangement by which the cinema went to the family of Shri Ram Krishan Tekriwal, the assessee taking net cash of Rs. 75,000 on its side.

12. Once we have settled the above question of fact based on the interpretation of the above documents, we have to see what are the further legal or factual consequences. The first consequence is that the assessee was not required to reimburse the firm for its debit balance of Rs. 56,182. According to the learned counsel for the assessee, the net debit balance or the amount payable by the assessee to the firm was only Rs. 30,770. This was arrived at after setting off the assessees share of profit due from the firm. In our opinion, the figures do not matter. In principle, the position is that the assessee was not required to pay anything to the firm. In such a situation, it cannot be said that the amount of Rs. 56,182 or any lesser amount received by the assessee either attracted section 41(2) or section 45.

13. We will now refer to the various authorities supporting our above view and which were cited mostly by the learned counsel for the assessee. The first authority is a decision of the Madras High Court in CIT v. P. Ganesa Chettiar : [1982]133ITR103(Mad) . It was held in this case that a debit forgiven or waived cannot constitute income and could not, therefore, be taxed. Another case is a decision of the Supreme Court in Malabar Fisheries Co. v. CIT : [1979]120ITR49(SC) . It was held in this case :

'Having regard to the above discussion, it seems to us clear that a partnership firm under the Indian Partnership Act, 1932, is not a distinct legal entity apart from the partners constituting it and equally in law the firm as such has no separate rights of its own in the partnership assets and when one talks of the firms property or firms assets all that is meant is property or assets in which all partners have a joint or common interest. If that be the position, it is difficult to accept the contentin that upon dissolution the firms rights in the partnership assets are extinguished. The firm as such has no separate rights of its own in the partnership assets are extinguished. The firm as such has no separate rights of its own in the partnership assets but it is the partners who own joinly or in common the assets of the partnership and, therefore, the consequence of the distribution, division or allotment of assets to the partners which flows upon dissolution after discharge of liabilities is nothing but a mutual adjustment of rights between the partners and there is no question of any extinguishment of the firms rights in the partnership assets amounting to a transfer of assets within the meaning of section 2(47) of the Act. In our view, therefore, there is no transfer of assets involved even in the sense of any extinguishment of the firms rights in the partnership assets when distribution takes placed upon dissolution. (p. 59)

In view of the above principles, section 45 will not be attracted to the above amount. The same view was expressed by the Supreme Court in an earlier case in CIT v. Banke Lal Vaidya : [1971]79ITR594(SC) . In this case, the assessee had entered into a partnership. On the dissolution of the partnership, its assets were valued at Rs. 2,50,000. Since a large majority of the assets was incapable of physical division it was agreed that the assets be taken over by the other partner and the assessee be paid his share of the value of the asset in money. The assessee was accordingly paid Rs. 1,25,000. The question was whether the sum of Rs. 65,000 being part of the amount received by the assessee could be brought to tax as capital gains. It was held 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 assessees share in the capital assets to the other partner, nor did he transfer his share in the capital assets. The sum of Rs. 65,000 could not be taxed as capital gains. Similar view was taken by the Allahabad High Court in Addl. CIT v. Smt. Mahinderpal Bhasin : [1979]117ITR26(All) . It was held that when a partner retires what he receives is really his share in the partnership assets after deducting the liabilities. It is not consideration for transfer of his interest in the partnership to the continuing partners. In the transaction of retirement of a partner, just as in the case of a dissolution of partnership, there is no element of transfer. The transaction is in law an adjustment of the rights of the partners and not relinquishment or even extinguishment of interest of the retiring partner. It is not necessary for us to refer to other cases, which in our opinion, either repear the above principle or are distinguishable on their own facts. The cases cited on behalf of the department are also distinguishable on their own facts. We, therefore, hold that the sum of Rs. 56,182 or Rs. 30,770 as worked out by the assessee was not taxable either under section 41(2) or under section 45.

14. We now come to the sake proceeds of Rs. 75,000. We have already held that this related to the assets after they had been received by the assessee on the dissolution of the firm. Such sale proceeds will attract capital gains if other conditions are satisfied. There is not dispute that other conditions are not satisfied in this case. The above amount besides including the sale proceeds of the assets received by the assessee from the firm also included the sale proceed of a building belonging to sugar

mills machinery Supplier. It is not clear to us whether the latter asset exclusively belonged to the assessee in its individual capacity. However, whatever might be the position, capital gains have to be worked out with reference to the entire amount of Rs. 75,000 as its working is independent of the firm of Vijai Picture Palace. We are considering the determination of the capital gains in the hands of the assessee as an independent entity. In that position, it will be liable to capital gains tax not only on those assets, which it had received from the firm but also on all other assets which were sold by it and should be a capital asset and that there should be a transfer of such capital asset. Both these conditions are satisfied in this case. Apparently the working of the capital gains will be as under :

Rs.

Rs.

Sale proceeds

75,000

Less: Written down value of the assets falling to the share of the assessee from the firm.

32,456

Written down value of the assets of sugar mill machinery suppliers

19,120

51,576

Difference

23,424

The above amount will further be subject to statutory exemption and the relife under section 80TT of the Act.

15. In the result, the appeal is partly allowed.