IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX REFERENCE NO. 203 OF 1994

The Commissioner of Income Tax,
Bombay City VII, Bombay. ...Applicant.

Vs.

Shri. Abid A.Kalvert,
Earnest House, Nariman Point,
Bombay-21. ...Respondent.

Mr. Suresh Kumar Advocate for the Applicant.
Mr. Percy Pardiwala, Senior Advocate -Amicus Curiae present.

CORAM : S.J.VAZIFDAR &
M.S. SANKLECHA, JJ.

DATE : 15th June, 2012

JUDGMENT (Per M.S. Sanklecha J.):

This is a reference under Section 256(1) of the Income Tax Act, 1961, at the instance of the Revenue for the Assessment Year 1978-79.

2) The following question arising out of its Order dated 18/7/1989 has been referred by the Income Tax Appellate Tribunal for the opinion of this Court:

Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in confirming the AAC's order in which the A.A.C. had held that it was a case of distribution of assets on dissolution of partnership and no capital gains accrued to the assessee-partners in view of the provisions of Section 47(ii) of the Income Tax Act,1961?

3) Briefly, the facts leading to the present application are that the respondent/assessee was a partner in the firm of M/s. A. Kalvert & Co. constituted under the Deed of Partnership dated 9/1/1969. The other partners of the firm were the father and brother of the respondent/assessee. Thereafter disputes arose between the partners resulting in a civil suit which was ultimately settled by the High Court passing a consent decree on 12/7/1977 resulting in formal dissolution of the firm with effect from 15/4/1974. The Income Tax Officer by his order held that an amount of Rs.80,090/- received by the respondent/assessee on dissolution of the partnership firm was chargeable to tax under the head capital gains. On first appeal, Appellate Assistant Commissioner by his order dated 30/3/1985 held that there was no question of

any amount being brought to tax as capital gains as the amount was received by the respondent-assessee on dissolution of the partnership firm, in view of the clear mandate of Section 47(ii) of the Income Tax Act, 1961 as existing at the relevant time. Being aggrieved by the order of the Appellate Assistant Commissioner, the Revenue preferred an appeal to the Income Tax Appellate Tribunal. However by its order dated 18/8/1989 the Income Tax Appellate Tribunal dismissed the appeal of the Revenue holding that amounts distributed on the dissolution of the partnership firm cannot be brought to tax as capital gains in view of Section 47(ii) of the Income Tax Act, 1961.

4) At all times relevant to this application, Section 47(ii) of the Income tax Act 1961 read as under:

"47. Nothing contained in Section 45 shall apply to the following transfers:-

(i) ....

(ii) Any distribution of capital assets on the dissolution of a firm, body of individuals or other association of persons;

(iii) .....".

5) Mr. Pardiwala, the learned Senior Advocate appearing as an amicus curie submits that any amount paid to a partner as his share on dissolution of the partnership firm cannot be regarded as transfer not only in view of the clear mandate of Section 47(ii) of the Income Tax Act, 1961 but also because such receipt of amounts and/or property does not involve an element of transfer within the meaning of the definition of the word transfer in Section 2(47) of the Income Tax Act, 1961.

6) Mr. Pardiwala pointed out that this Court in the matter of Tribhuvandas G. Patel, reported in (1978) 115 ITR 95 had taken a view that when on retirement a partner received consideration then the amount so received is to be regarded as a transfer within the meaning of Section 2(47) of the Income Tax Act, 1961, inasmuch as it could be said that the retiring partner has assigned, released and/or relinqu ished his interest and share in partnership firm in favour of the existing partners.

However the aforesaid view of the Bombay High Court had been reversed by the Supreme Court in Tribhuvandas G. Patel Vs. C.I.T. 236 ITR 515 wherein it has been held that any sum received by a partner on his retirement the same cannot be brought to tax as capital gains by virtue of Section 47(ii) of the Income Tax Act, 1961 as existing at the material time. The Supreme Court placed reliance upon its earlier decisions in the matters of Sunil Siddharthbhai reported in 156 ITR 509(S.C.) and Mohanbhai Pamabhai reported in 165 ITR 166.

7) In the case of Sunil Siddarthbhai(supra) the issue for consideration was whether capital gains is attracted on a partner introducing capital assets in the partnership firm. The Supreme Court held that there was a transfer when a person introduces his personal property as a capital in a partnership firm. The basis of the above was that on introduction of property into the firm there is a reduction in the exclusive interest which an individual had over the property as it is reduced to a joint or shared interest with other partners and therefore to that extent there would a transfer of property. However, the consideration for the same according to the Court could not be evaluated immediately as the interest of the partner is subject to the future transactions of the partnership and the evaluation of the partners interest can only take place upon the dissolution of the firm and/or retirement of the partner from the firm. The Supreme Court inter alia observed as under:

"What the partner gets upon dissolution or upon retirement is the realization of a pre existing right or interest . It is nothing strange in the law that a right or interest should exist in presenti but its realisation or exercise should be postponed. Therefore, what was the exclusive interest of a partner in his personal asset, is upon its introduction into the partnership firm as his share to the partnership capital, transformed into an interest shared with the other partners in the asset. Qua that asset, there is a shared interest. During the subsistence of the partnership, the interest of each partner qua that asset cannot be isolated or carved out from the value of the partner's interest in the totality of the partnership assets and in regard to the latter, the value will be represented by his share in the net assets on the dissolution of the firm or upon the partner's retirement."

8) Mr. Pardiwala also invited our attention to a recent decision of our Court in the matter of Prashant Joshi Vs. Income Tax Officer and anr. reported in 324 ITR

124. In the above case the Court after considering the aforesaid decisions of the Supreme Court has observed :

> *"During the subsistence of a partnership, a partner does not possess an interest in specific 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 S.2(47)".*

9) The aforesaid decisions will apply with greater force in respect of any sum received by a partner on dissolution of a firm as the same is specifically covered by Section 47(ii) of the Income Tax Act, 1961 as existing during the Assessment Year 1978-79. Therefore the question is answered in the affirmative i.e. in favour of the Assessee and against the Revenue.

10) We would like to place on record our appreciation of the assistance rendered to us by Mr. Percy Pardiwala in this matter.

11) The Reference is disposed of in above terms. No order as to costs.

(M.S. SANKLECHA, J.) (S. J. VAZIFDAR, J.)