`IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

WRIT PETITION NO.191 OF 2010

Balkrishna Hiralal Wani,)
residing at B-5, Wayward,Sitladevi)
Temple Road, Mahim, Mumbai - 400 016.)..Petitioner.

V/s.

1. Income Tax Officer,)
Ward No.11, (2)(2), having her Office)
Aayakar Bhavan, Mumbai-400 020.)
)
2. Commissioner of Income Tax)
Ward No.11, (2), having his Office)
Aayakar Bhavan, Mumbai-400 020.)
)
3. Union of India)
through the Secretary, Ministry of Finance)
Government of India North Block,)
New Delhi 110 101.)..Respondents.

Mr. J.D. Mistri with Ms. Supriya S. Devargudi i/b. ANS Law Associates for petitioner.

Mr. Vimal Gupta for respondents.

CORAM : DR. D.Y.CHANDRACHUD
AND J.P.DEVADHAR, JJ.

DATED : 10TH FEBRUARY, 2010

JUDGMENT (PER DR. D.Y.CHANDRACHUD, J.)

1. Rule, by consent made returnable forthwith. Counsel for the respondents waives service. With the consent of counsel, the petition is taken up for final hearing.

2. The petitioner who is a partner in a firm of Solicitors retired on 20th October, 2003 on attaining the age of seventy years. Clause 33 of the Deed of partnership stipulates that all partners shall retire from the firm on reaching the age of seventy years. The Deed of partnership provides for three modes by which a person may cease to be a partner. Clause 32 provides for a voluntary retirement of a partner; clause 33 provides for retirement on the attainment of superannuation; and clause 41 provides for certain eventualities such as insolvency, professional misconduct or conviction of an offence involving moral turpitude upon which a partner shall become disqualified. Clause 35 of the Deed of Partnership provides as follows:-

> " A partner who has retired voluntarily or has been required to withdraw from the firm under clause 41 of this deed shall not, so long as the continuing or surviving partners or any of them shall carry on the said business, for a period of three years from such retirement or withdrawal, solicit the clients of the firm. "

3. On retirement from the firm, the petitioner became entitled to a sum of Rs.1,73,25,000/- which was payable in eight instalments. During the course of the previous year relevant to assessment year 2004-05, the petitioner received an amount of Rs.21,65,625/-, out of the total amount receivable. In his return of income for assessment year 2004-05, the petitioner disclosed receipt of the aforesaid amount and claimed, in a note appended to the return, that during the year he had retired from the firm with effect from 22nd October, 2003; the amount receivable on retirement was not liable to tax and out of the total amount, the aforesaid instalment has been

received from the firm.

4. A notice under section 148 was issued to the petitioner on 30th March, 2009 stating that the Assessing Officer had reason to believe that the income chargeable to tax for assessment year 2004-05 had escaped assessment within the meaning of section 147 and as a consequence, the Assessing Officer proposed to reassess the income. The petitioner by a letter dated 13th April, 2009 requested the Assessing Officer to disclose the reasons. On 10th September, 2009 the reasons on the basis of which the Assessing Officer had reason to believe that income had escaped assessment were disclosed to the petitioner. The reasons were to the following effect:-

> " The assessee was a partner in the firm of M/s. Little & Co. The assessee retired from the partnership firm during the F.Y. 2003-04. On retirement i.e. 22-10-03 the assessee had received certain amount from the firm. As per the foot notes of computation of total income furnished with the return of income, the assessee has shown receivable from Little & Co. on retirement amounting to Rs.21,65,625/- and the same is not liable to tax.
>
> 0.2. Clause 35 of the Partnership deed dt. 1-1-03 restricts the retiring partners for 3 years and stipulates for them not to impinge upon the client of the firm. Provisions of clause 35 are reproduced herewith.
>
> *" A partner who has retired voluntarily or has been required to withdraw from the firm under clause 41 of this Deed shall not, so long as the continuing or surviving partners or any of them shall carry on the said business, for a period of three years from such retirement or withdrawal, solicit the clients of the firm."*

0.3 Thus, it is clear that the amount paid by the firm to the retiring partners is on account of retiring partners' renunciation of their rights to have free trade and profession envisaged in the constitution of India for three years and thus amount received by the retiring partners are liable to capital gain tax as explained in sec 28(va). The firm has simply purchased the shares of the retiring partners by paying the amount as per clause 38 of the said Deed.

0.4 In view of the above facts, I have reason to believe that an amount of Rs.21,65,625/- received by the assessee on retirement has escaped assessment chargeable to tax within the purview of sec. 147 of the Income Tax Act, 1961 for Asstt. Year 2004-05. Therefore, a notice u/s.148 is being issued. " (emphasis supplied)

5. On 23rd October, 2009 the petitioner lodged his objections to the reasons recorded by the Assessing Officer. The contention of the petitioner was that (i) Clause 35 of the Deed of partnership had no application to a situation where a partner had retired mandatorily on attaining the age of seventy years. Ex-facie, clause 35 applies only to a partner who has retired voluntarily or who has been required to retire under clause 41; (ii) Section 28(va) refers to a sum received or receivable for carrying out any activity in relation to any business. There is a distinction between the expression “business” which is defined in section 2(13) and the expression “profession” defined in 2(36). Section 28(va) has no application to an amount received in relation to a profession. In any event, the petitioner had not renounced any right to carry on his profession within the meaning of section 28(va); (iii) The amount which has been paid to the petitioner was out of a reserve fund

established and maintained to pay retiring partners of the firm. There was no purchase of a share of the retiring partner, by the payment of the amount in accordance with clause 38 of the partnership deed.

6. The objections were disposed of by the Assessing Officer by an order dated 2nd December, 2009. The Assessing Officer observed that the amount received by the petitioner on his retirement was assessable under section 28(iv) as the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession.

7. Aggrieved by the notice purporting to reassess the income of the petitioner on the ground that the income has escaped the assessment, the petitioner has moved a petition under Article 226 of the Constitution of India.

8. On behalf of the petitioner, it has been submitted that the jurisdictional condition precedent for reopening an assessment for a valid exercise of powers under section 147 has not been fulfilled. Though in the present case, notice under section 148 has been issued within a period of four years of the expiry of the relevant assessment year and there is no order of assessment under 143(3), nonetheless, in view of the well settled position of law, it is urged that the Assessing Officer must have tangible material on the basis of which he can have a reason to believe that income has escaped assessment. In the present case, it is submitted that there was a total absence of any tangible material to form a belief. The existence of belief

must be tested on the basis of the reasons recorded. Ex-facie, the reasons recorded would belie the existence of any reason to believe that the payment that was received by the petitioner was in consideration of a renunciation of the right to carry on his profession. In any event, clause 35 of the Deed of partnership can have no application to a payment received by a partner who attains the age of superannuation under clause 33. Moreover, it was submitted that it is a well settled position of law that when a payment is made to a partner retiring from a firm that represents his share in the net assets upon drawing of accounts and no element of transfer is involved within the meaning of 2(45). It is submitted that the reasons recorded by the Assessing Officer referred to section 28(va). On the other hand, while disposing of the objections of the assessee, the Assessing Officer has adverted to section 28(iv). It is now settled position that payment which is made in money would not fall within the ambit of section 28(iv). Assuming that the Assessing Officer was entitled to correct a mistake, if any, section 28(va) would also have no application. In these circumstances, it was submitted that the jurisdictional condition for the exercise of the power is absent in the present case.

9. On behalf of the Revenue, it has been submitted that an assessment has not been carried out in the present case and the exercise of power by the issuance of a notice under section 148 is within a period of four years. It has been urged that at this stage, material which has been produced before the Court was not produced before the Assessing Officer and consequently, interference under Article 226 of the Constitution of India

was not warranted since it would be for the Assessing Officer to determine as to whether income has, as a matter of fact, escaped assessment. However, during the course of submissions, counsel appearing on behalf of the Revenue submitted that while recording his reasons, the Assessing Officer had erroneously referred to clause 35 of the Deed of partnership, which would have no application to the retirement of a partner upon attaining the age of superannuation. Moreover, it is also fairly stated that the Assessing Officer seeks to set up the case that the amount received is taxable under section 28(iv) of the Act.

10. Section 147 empowers the Assessing Officer to assess or reassess income, which he has reason to believe has escaped assessment for the assessment year. The existence of a reason to believe is the condition precedent to the exercise of power and the reasons must be recorded in writing. The proviso to section 147 imposes an additional condition in a situation where action is sought to be taken after the expiry of four years from the end of the relevant assessment year and that condition is that the income chargeable to tax must have escaped assessment for such assessment year by reason of the failure on the part of the assessee inter alia to disclose fully and truly all material facts necessary for the assessment for that assessment year. In the present case, admittedly, the notice under Section 148 has been issued within a period of four years of the expiry of relevant assessment year. Therefore, the condition which is imposed by the proviso to section 147 has no application. The only question in such a case is as to whether the Assessing Officer had reason to believe that income

chargeable to tax had escaped assessment. Another facet of the matter which must be taken into consideration is that in the present case, an assessment order has not been passed under section 143(3), a circumstance which has been emphasised by counsel for the Revenue. The case is, therefore, at the stage of an intimation under section 143(1). After 1st April, 1989 the power to reopen an assessment has been widened as compared to the position as it stood prior to that date. But it is settled law that Section 147 has to be given a schematic interpretation to ensure against an arbitrary exercise of power. The manner in which the provisions of section 147 should be construed is clarified in the judgment of the Supreme Court in **Commissioner of Income Tax V/s. Kelvinator of India Ltd.**[1] The Supreme Court held as follows:-

> " ...post-1st April, 1989, power to reopen is much wider. However, one needs to give a schematic interpretation to the words "reason to believe" failing which, we are afraid, section 147 would give arbitrary powers to the Assessing Officer to reopen assessments on the basis of "mere change of opinion", which cannot be per se reason to reopen. We must also keep in mind the conceptual difference between power to review and power to reassess. But reassessment has to be based on fulfilment of certain pre-conditions and if the concept of "change of opinion" is removed, as contended on behalf of the Department, then, in the garb of reopening the assessment, review would take place. One must treat the concept of "change of opinion" as an in-built test to check abuse of power by the Assessing Officer. Hence, after 1st April, 1989, the Assessing Officer has power to reopen, provided there is "tangible material" to come to the conclusion that there is escapement of income from assessment. Reasons must have a link with the formation of the belief.... "

11. In the present case, while recording his reasons for the formation of belief that income has escaped assessment, the Assessing

1 [2010] 320 ITR 561 (SC)

Officer placed reliance on clause 35 of the Deed of partnership. Clause 35 states that a partner who is retiring voluntarily or has been required to withdraw from the firm under clause 41 shall not, so long as the continuing or surviving partners or any of them shall carry on the business, solicit the clients of the firm for a period of three years. The inference which the Assessing Officer draws from clause 35 is that "the amount paid by the firm to the retiring partner is on account of the retiring partner's renunciation of the right to have free trade and profession envisaged in the Constitution of India for three years". Ex-facie, a reading of the clause as it stands shows that the inference is without any logical foundation. What clause 35 postulates is that a partner who is retiring voluntarily or who has been required to withdraw from the firm under clause 41 will not solicit the clients of the firm for a period of three years, if the remaining partners carry on the business. A partner, in other words, does not renounce his right to carry on the profession. But more importantly, clause 35 has no application whatsoever to a situation where a partner has retired mandatorily upon attaining the age of superannuation of seventy years. In so far as the assessee is concerned, the age of superannuation was seventy years. During the course of the submissions, as noted earlier, counsel appearing for the Revenue stated that there was an error on the part of the Assessing Officer in referring to clause 35 of the Deed of partnership. Once this is the position, and we have no doubt that the concession which has been made by learned counsel is in accord with a plain reading of the Deed of partnership, the basis and foundation for the formation of the belief that income has escaped assessment ceases to exist. Principally it was on the basis of clause 35 that

the Assessing officer formed a reason to believe that income had escaped the assessment.

12. Counsel for the Revenue submitted that while disposing of the objections of the assessee, the Assessing Officer purported to rely on the provisions of Section 28(iv) under which, according to him, the amount received by the petitioner was taxable. In so far as this Court is concerned, a Division Bench of the Court in **Mahindra and Mahindra Ltd. V/s. Commissioner of Income Tax**[2] held that income which can be taxed under section 28(iv) must not only be referable to a benefit or perquisite, but it must be arising from business. Secondly, section 28(iv) does not apply to benefits in cash or money. This Court followed the decision of Gujarat High Court in **CIT v. Alchemic Pvt. Ltd.**[3] Therefore, considered from all perspectives, the reasons which have been disclosed by the Assessing Officer, can by no stretch of logic lead a prudent person to form a reason to believe that income has escaped assessment. For the purpose of determining the validity of the challenge to the notice under section 148, the Court would have to refer to the reasons recorded by the Assessing Officer and to those reasons alone.

13. Thus, there was, in our opinion, no tangible material before the Assessing Officer, as explained in the judgment of the Supreme Court in *Kelvinator (supra)* to form a conclusion that income has escaped assessment. Hence though no assessment order was passed under section

2 (2003) ITR 261 (Bom)
3 (1981) 130 ITR 168 (Guj)

143(3), we are of the view that the jurisdictional condition precedent prior to the exercise of the power to reopening the assessment under Section 147 of the Act has not been fulfilled. The petition will, therefore, have to be allowed.

14. Rule is made absolute in terms of prayer clause (a) by quashing and setting the notice dated 30th March, 2009 and the order dated 2nd December, 2009. In the circumstances, there shall be no order as to costs.

(J.P.DEVADHAR, J.) (DR. D.Y.CHANDRACHUD, J.)