IN THE INCOME TAX APPELLATE TRIBUNAL, MUMBAI 'D' BENCH, MUMBAI

Before Shri P.M. Jagtap, Vice-President (KZ) (Third Member)

I.T.A. Nos. 3526 & 3527/MUM/2012
Assessment Years: 2006-2007 & 2007-2008

M/s. D.S. Corporation,.....Appellant
M/s. Thar & Co., Chartered Accountants,
203, Capri Building, Opp. HDIL Tower,
Anant Kanekar Marg,
Bandra (E), Mumbai-400 051
[PAN: AAFFD 2266 C]

-Vs.-

Income Tax Officer-21(1)(4), Mumbai.....Respondent
C-11, Pratyaksh Kar Bhavan,
BKC, Bandra (E),
Mumbai-400 051

&

I.T.A. Nos. 3882 & 3883/MUM/2012
Assessment Years: 2006-2007 & 2007-2008

Income Tax Officer-21(1)(4), Mumbai,.....Appellant
C-11, Pratyaksh Kar Bhavan,
BKC, Bandra (E),
Mumbai-400 051

-Vs.-

M/s. D.S. Corporation,.....Respondent
M/s. Thar & Co., Chartered Accountants,
203, Capri Building, Opp. HDIL Tower,
Anant Kanekar Marg,
Bandra (E), Mumbai-400 051
[PAN: AAFFD 2266 C]

Appearances by:
Dr. K. Shivaram & Shri Rahul Hakani, for the assessee
Shri Ajay Kumar, for the Department

Date of concluding the hearing : November 15, 2018

O R D E R

Per Shri P.M. Jagtap, Vice-President (KZ):-

On account of difference of opinion between the learned Accountant Member and learned Judicial Member, Mumbai Benches, this matter has been referred to me by the Hon'ble President, ITAT for consideration and decision under section 254(4) of the Income Tax Act, 1961 (hereinafter "the Act"). While referring the matter to Third Member, separate three questions each were framed by both the differing Members. In order to settle and finalise the questions that are required to be considered and decided by the Third Member, the learned Representatives of both sides were required to propose draft questions in such a manner that the same shall project the exact controversy involved in the point of reference. They were directed to confine themselves to the order of reference while preparing the draft questions and not to enlarge or modify the point of difference referred by the differing Members to the Third Member. Accordingly the learned Representatives of both the sides have proposed draft questions and after a detailed discussion and deliberation, it is agreed that question Nos. 2 & 3 as suggested by the Sr. DR correctly incorporate the exact controversy in the point of difference. It is accordingly settled and finalised that the said two questions are required to be considered and decided by the Third Member in this case to resolve the controversy in the point of difference between the differing Members. The said two questions are as under: -

> *" 1. Whether on the facts and in the circumstances of case, where on revaluation of asset being land held by the partnership firm which resulted into enhancement of value of asset and this enhanced amount credited in capital account of partners and when a retiring partner takes amount in his capital account including enhanced value of asset, it gives rise to Capital Gain under section 45(4) r.w. Section 2(14) of the Income Tax Act.*
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> *2. Whether on the facts and in the circumstances of the case, is there any transfer of capital asset on dissolution*

of firm or "otherwise" within the meaning of Section 45(4) r.w. Section 2(14), in case the money equivalent is paid by partnership firm to the retiring partner and whether this money equivalent to enhanced portion of the asset revalued constitutes capital asset for the purpose of Section 45(4) r.w. Section 2(14) of the Income Tax Act.

2. Although the learned Accountant Member and learned Judicial Member both have narrated the facts relevant to the controversy referred to the Third Member as involved in the present case, I recapitulate the same in brief for the sake of completeness and ready reference. The assessee in the present case is a partnership firm which was originally constituted vide Deed of Partnership entered into on 01.08.2005. The object of the partnership firm was to carry on the business of development and construction in partnership and the said partnership was originally constituted by two partners, namely Shri Rakesh Kumar Wadhwan and Shri Sudhakar M. Shetty with profit sharing ratio of 60% and 40% respectively. On 16.09.2005, the partnership was reconstituted by admitting Smt. Hemlata S. Shetty as partner with a revised profit sharing ratio of Shri Rakesh Kumar Wadhwan, Shri Sudhakar M. Shetty and Smt. Hemlata S. Shetty being 60%, 20% and 20% respectively. Thereafter on 23.09.2005, the assessee firm purchased from Shri Percival Joseph Pereira a property bearing Survey No. 28A and B 1, Plot No. 2 and CTS No. 956,956/1 to 956/83 of Village Juhu, Taqluka Andheri, Mumbai Suburb, Grater Mumbai for a consideration of 6.5 crores. The said property admeasuring 14022 sq. yards, formerly known as Perieria Estate and later known as Unit Compound, comprised of land and buildings and structures occupied by tenants. Immediately after purchase of the said property, the partnership was again reconstituted by admitting two new partners, namely Prithvi Realtors & Capital Pvt. Ltd. and Shri Sarang R. Wadhwan. While the profit sharing ratio in the reconstituted partnership of Shri Sudhakar Shetty and Smt. Hemlata S. Shetty remained at 20% each, the same in the case of Shri Rakesh Kumar Wadhwan was reduced to 35%

with M/s. Prithvi Realtors & Capital P. Ltd. and Shri Barang R. Wadhwan getting 20% and 5%. With the efforts of the partnership firm, Maharashtra Tourism Development Corporation vide letter dated 18.01.2006 and the Government of India, Ministry of Tourism vide letter dated 18.01.2006 granted permission to the assessee firm to construct five star hotel on the property purchased by it at Juhu Tara Road. Meanwhile the assessee firm also arrived at a settlement with 77 of the 81 tenants who had occupied the said property. Thereafter the assessee firm decided to revalue the property and as per the valuation made by a Registered Valuer, Shri A.R.Nigam vide valuation report dated 25.03.2006, the property was revalued at 1,93,90,60,000/-. On the basis of the said valuation done by the Registered Valuer, revaluation surplus was created in the books of account of the assessee firm and the same was credited to the capital accounts of all the partners in their profit sharing ratio. On 27.03.2006, the partnership was again reconstituted whereby Smt. Hemlata Shetty retired from the partnership firm and her profit sharing ratio of 20% was given to four new partners at 5% each, who were admitted to the partnership firm. On retirement, Smt. Hemlata Shetty was paid the entire amount of 31,40,48,088/- standing to the credit of her capital account including the amount of 30,87,98,087/- credited on account of revaluation surplus. Similarly Shri Sudhakar Shetty retired from the partnership on 22.05.2006 getting the amount of 35,59,84,050/- standing to the credit of his capital account including his share of revaluation surplus amounting to 30,87,98,807/-. In their respective returns of income, the retiring partners Shri Sudhakar Shetty and Smt. Hemlata Shetty claimed the amount received by them from the assessee firm on retirement as exempt under section 10(2A) of the Act.

3. The AO received the information regarding retirement of the two partners, namely, Smt. Hemlata Shetty and Shri Sudhakar Shetty on 27.03.2006 and 25.05.2006 respectively. He also received information

about the amounts of 31,40,48,088/- & Rs.35,59,84,050/- received by them from the assessee firm on retirement. Based on this information, the AO was of the prima facie view that there was transfer of capital asset by way of distribution by the assessee firm to the retiring partners in terms of section 45(4) of the Act and assessee firm was liable to tax on the capital gain arising from such transfer as held by the Hori'ble Bombay High Court in the case of **CIT vs. A.N. Naik Associates (265 ITR 346)**. Since such capital gain was not declared by the assessee in the returns of income filed for assessment years 2007-07 and 2007-08, he reopened the assessments for the said two years after recording the reasons. In pursuance of the assessments reopened by him, reassessments were completed by the AO under section 143(3)/147 of the Act. In the said assessments, he held that it was not only the retiring partners whose capital accounts had been credited by their share of revaluation surplus, but the capital accounts of all the partners were also credited. He held that if the retiring partners had got equivalent rights in the form of their money, the other partners also got their increased capital in the assessee firm as a result of crediting of revaluation surplus. He held that the equivalent amount of money standing to their capital accounts on account of revaluation surplus as well as to the continuing partners capital account credited as a result of revaluation of assets of the assessee firm was nothing but distribution of capital assets of the assessee firm among the partners on dissolution or otherwise and the valuation surplus of 1,54,39,90,435/- worked out on the basis of market value of the assets was chargeable to tax as capital gain in the hands of the assessee firm being distribution of capital assets by way of dissolution of the partnership firm or otherwise in terms of Section 45(4) of the Act. To arrive at this conclusion, the AO relied on the decisions of the Hon'ble Supreme Court in the case of **CIT vs. Bankey Lal Vaidya (79 ITR 594)** and **Dewas Cine Corporation (68 ITR 240)** and the decision of the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)**.

4. The action of the AO in bringing to tax the revaluation surplus of 1,54,39,90,435/ - as capital gain by applying provisions of Section 45(4) of the Act was challenged by the assessees in the appeals filed before the learned CIT(A) and after considering the submissions made by the assessees as well as the material available on record, the learned CIT(A) held that there was no dissolution of partnership firm either at the time of retirement of Smt. Hemlata Shetty on 26.03.2006 or at the time of retirement of Shri Sudhakar Shetty on 25.05.2006. According to him, there was only reconstitution of the partnership firm with change of partners and there was nothing in the retirement deed to suggest any intention to liquidate the assets of the firm and distribute the capital assets of the firm to the partners of the firm. He also held that Shri Sudhakar Shetty and Smt. Hemlata Shetty had retired from the partnership firm without any distribution of assets of the partnership firm. He held that it was not the case where all the old partners of the erstwhile firm had retired and the old firm was succeeded by new firm and new partners. He held that the surplus on the revaluation of assets was notionally credited to the capital account of the five original partners on 26.03.2006 for mutual adjustment of rights of partners and the retiring partners were paid only the sum standing to the credit of their capital accounts. He held that while the firm was succeeding, there could not be any transfer of rights in the assets of the firm amongst the retiring partners, subsisting partners and the new partners. He held that there could be no transfer to oneself and this can happen only when there is a dissolution of partnership firm, which had not happened in the case of the assessee. He observed that there was no change of ownership of the capital assets in assessee's case after revaluation in as much as partnership firm continued to be the absolute owner of the said assets. He held that it was thus not a case of dissolution of the partnership firm or transfer of assets of the partnership firm and provisions of Section

45(4) were not attracted. Reliance was placed by the learned CIT(A) on the decision of the Hon'ble Kerala High Court in the case of **CIT vs. Kunnankulam Mill Board (257 ITR 544)** to hold that unless and until there is a change in the ownership of the capital asset, there cannot be any distribution of capital assets as contemplated in Section 45(4) of the Act. He also held that revaluation or retirement alone does not trigger provisions of Section 45(4) of the Act unless and until it is coupled with distribution of capital assets. The learned CIT(A) also placed reliance on the decision of the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)** to hold that in order to bring any event within the sweep of Section 45(4), there has to be a transfer of capital asset at the time of dissolution or other similar event such as retirement. He observed that there was no extinguishment of any right in any asset of the firm by the continuing partnership firm and hence there was no transfer of any kind within the meaning of Section 2(47) of the Act. The learned CIT(A) also considered the judicial pronouncements relied upon by the Assessing Officer to make out the case of application of Section 45(4) of the Act and found the same to be distinguishable on facts. The learned CIT(A) accordingly arrived at a conclusion that there was no distribution of capital assets by the assessee firm as a result of revaluation and retirement of partners as envisaged in Section 45(4) of the Act and directed the AO to delete the addition of 1,54,39,90,435/- made on account of capital gain by applying the said provision.

5. Aggrieved by the relief given by the learned CIT(A) to the assessee by deleting the addition made by the AO on account of capital gain by applying provisions of Section 45(4) of the Act, an appeal was preferred by the Revenue before the Tribunal. After considering the submissions of both the sides and the material available on record including the judicial pronouncements cited by both the sides, the learned Accountant Member proposed a lead order. In the said order, he initially referred to the

provisions of Section 45(4) of the Act as inserted in the statute by Finance Act, 1987 w.e.f. 01.04.1988 and also took note of the deletion of provisions of Section 47(ii) of the Act by Finance Act, 1987 simultaneously. He then referred to the memorandum explaining the provisions of the Finance Act, 1987 to note that section 45(4) of the Act was amended as anti tax avoidance measure to plug loopholes and to avoid misuse by partnership firms for avoiding to pay capital gains tax on transfer of capital assets from partner to firm or transfer by way of distribution of capital assets on dissolution of firm or otherwise. He then referred to the definition of capital assets given in Section 2(14) of the Act to note that the expression capital asset is very widely defined to include property of any kind. He also relied on the decision of the Hon'ble Delhi High Court in the case of **PNB Finance Ltd. vs. CIT (252 ITR 491)**, wherein it was held that all inclusive definition of the term 'capital asset' brings within its ambit property of any kind held by the assessee. It was also held that the term property is of widest import and subject to any limitations which the context may require, it signifies every possible interest which a person can acquire, hold or enjoy.

6. After referring to the relevant provisions and discussing the scope thereof, the learned Accountant Member relied upon the decision of the Hon'ble Supreme Court in the case of **Tribhuvan G. Patel vs. CIT 236 ITR 515** wherein it was held that even where a partner retires and some amount is paid to him towards his share in the assets, it should be treated as falling under clause (ii) of Section 47 of the Act. By relying on the wording of clause (ii) of Section 47 at it stood prior to the deletion, the learned Accountant Member held that payment of amount to the retiring partner towards his share in the assets of the partnership firm amounts to distribution of capital asset on retirement and the same now falls within the ambit of Section 45(4) of the Act as inserted by the Finance Act, 1987 w.e.f. 01.04.1988. He held that use of the word "otherwise" in

Section 45(4) of the Act would take within its ambit not only the case of transfer of capital asset by way of distribution of capital asset on dissolution of the firm but also takes within its sweep cases where transfer of capital asset by way of distribution of capital asset takes place on retirement, death etc. of partner and money equivalent is distributed in lieu of assets towards the share of the partner. To arrive at this conclusion, the learned Accountant Member relied on the decision of the Hon'ble Supreme Court in the case of **CIT v. Bankey Lal Vaidya (1971) 79 ITR 594(SC)** and the decision of the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)**. He accordingly held that even distribution of money equivalent to the retiring partners towards their share shall also fall within the ambit of transfer under section 2(47) of the Act and will fall within the sweep of chargeability to tax as per the provisions of section 45(4) of the Act keeping in view the deletion of clause (ii) of Section 47 of the Act by Finance Act, 1987 w.e.f. 01.04.1988 and the definition of capital asset as contained in Section 2(24) of the Act which is of widest amplitude. He accordingly held that the addition made by the AO on account of capital gain to the total income of the assessee firm by application of Section 45(4) of the Act was sustainable but only to the extent of surplus arising out of revaluation of property which stood distributed by way of money equivalent to Smt. Hemlata Shetty and Shri Sudhakar Shetty on their retirement from the partnership firm. He held that the balance addition made by the AO on account of capital gain in the hands of the assessee firm on account of revaluation surplus credited to the capital of the other partners, who continued and did not retire during the years under consideration, could not be sustained as there was no transfer on distribution of capital asset to those non-retiring partners. The learned Accountant Member accordingly held that the addition made by the AO on account of capital gains amounting to 1,54,39,90,435/- by applying Section 54(4) of the Act was sustainable to the extent of Rs.61,75,97,614/-.

7. The learned Judicial Member did not agree with the view taken by the learned Accountant Member that there was a transfer of capital assets by way of distribution of capital asset on retirement of two partners from the assessee firm within the meaning of Section 45(4) of the Act in the facts and circumstances of the assessee's case. Accordingly he proceeded to pass a separate order expressing his dissenting view.

8. In his order passed separately, the ld. Judicial Member held that the decision of the Hon'ble Bombay High Court in the case of **CIT –vs.- A.N. Naik Associates (supra)**, of Hon'ble Supreme Court in the case of **CIT – vs.- Bankey Lal Vaidya (supra)** and of the Hon'ble Karnataka High Court in the case of **Kirolskar Asia Limited –vs.- CIT (supra)** relied upon by the ld. Accountant Member to come to his conclusion were rendered in altogether different facts and the ratio of the same, therefore, was not applicable to the facts of the present case. He held that in the case of A.N. Naik Associates (supra), there was a Memorandum of family settlement in the family of the assessee, according to which, the assets were distributed among various partners and various firms. He held that there was thus transfer of assets of the firm among the partners as well as various firms due to family settlement as a result of which the assets of the partnership firm were transferred to the retiring partners. He held that the partnership firm thus had ceased to have a right in the assets and since its right in the property stood extinguished in favour of the partners, it was held by the Hon'ble Bombay High Court that there was a transfer of capital assets within the meaning of section 45(4) of the Act. It was held by the Hon'ble Bombay High Court that the word "otherwise" used in section 45(4) takes into its sweep not only the cases of dissolution but also cases of subsisting partners of a partnership transferring the assets in favour of retiring partner. He held that the facts involved in the present case, however, were different, inasmuch as, except payment of

money standing to the credit of the partners' capital account in the partnership, there was no physical transfer of any asset by the partnership firm and the decision of the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)** was not applicable. He held that what was paid to the retiring partner was only the money standing to the credit of his/her capital account and hence, there was no distribution of any capital assets by way of transfer so as to attract the provisions of section 45(4) of the Act.

9. The ld. Judicial Member referred to the decision of the Full Bench of Hon'ble Karnataka High Court in the case of **CIT-vs.- Dynamic Enterprises [359 ITR 83]** to note that while deciding the similar issue in the similar facts and circumstances of the case as involved in the present case, Hon'ble Karnataka High Court has also found the decision of the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)** to be distinguishable on facts. He relied on the said decision of the Full Bench of the Hon'ble Karnataka High Court in the case of **Dynamic Enterprises (supra)**, wherein it was held that when a retiring partner took cash for the value of his share in the partnership firm, there was no distribution of capital assets among partners and there was no transfer of capital assets rendering section 45(4) inapplicable. He noted that the facts involved in the said case were identical to that of the case of the assessee, inasmuch as there was reconstitution of the firm without dissolution and the firm existed even on retirement of the partners, who were paid amounts standing to their credit in their capital account including their share in the re-valued assets.

10. The ld. Judicial Member referred to the decision of the Coordinate Bench of the Tribunal in the case of **Keshav & Co. -Vs.- ITO [161 ITD 798]**, wherein it was held that what the partnership firm had paid to the retiring partner was the compensation for all his rights in the

partnership firm and since there was no transfer of any assets or property of the partnership firm to its partner, section 45(4) had no application. He also relied on another decision of the Coordinate Bench of the ITAT in the case of **Mahul Construction Corporation –vs. – ITO (ITA No. 2784/MUM/2017 dated 24.11.2017)**, wherein the retiring partner was paid money standing to the credit of his capital account without transfer of any capital asset of the firm to the partner on retirement and it was held by the Tribunal that the provisions of section 45(4) were not attracted. As noted by the ld. Judicial Member, the said decision was rendered by the Tribunal after considering and distinguishing the decision of the Hon'ble Bombay High Court in the case of **CIT –vs.- A.N. Naik Associates (supra)** by observing that in the case of A.N. Naik Associates, even though there was no dissolution of the partnership firm, there was distribution of assets among the partners attracting the provisions of section 45(4) of the Act. As regards the decision of the Hon'ble Supreme Court in the case of **CIT –vs.- Bankey Lal Vaidya (supra)** relied upon by the ld. Accountant Member, the ld. Judicial Member noted that the facts involved in the said case were that there was a dissolution of firm and the two partners wanted to distribute the assets among themselves and one of the partners did not agree to sell/exchange or transfer his shares in assets of the firm and finally agreed to receive money equivalent to his share. The other partner accordingly agreed to pay the money on the basis of assets valued on dissolution and took over the assets of the firm on dissolution. He held that the Hon'ble Supreme Court in these facts and circumstances of the case held that the money value of the partner's share in assets of the firm received by partner amounted to distribution of assets of the firm on dissolution. He observed that the Hon'ble Apex Court, however, finally held that no capital gain arose on the value of money paid to the retiring partner as there was no sale or exchange or transfer of assets. He held that the decision of the Hon'ble Supreme Court in the case of **Bankey Lal Vaidya (supra)** thus

had no application to the facts of the assessee's case. He further held that the decision of the Hon'ble Karnataka High Court in the case of **Kirloskar Asia Limited (supra)** relied upon by the ld. Accountant Member was also not applicable in the present case as the same was distinguishable on facts.

11. The ld. Judicial Member finally held that the decision of Full Bench of Hon'ble Karnataka High Court in the case of Dynamic Enterprises (supra) as well as the decision of the Coordinate Bench of the Tribunal in the case of **Keshav & Co. (supra)** and **Mahul Corporation (supra)** was squarely applicable to the facts of the assessee's case and the ld. Accountant Member was not correct in overlooking the same and applying the decision of the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)**, which was found to be distinguishable on facts by the Hon'ble Karnataka High Court in the case of **Dynamic Enterprises (supra)** as well as by the Coordinate Bench of the ITAT in the case of **Keshav & Co. (supra)** and **Mahul Corporation (supra)**. He accordingly held that the money standing to the credit of partner in his/her capital account paid on retirement could not be taxed as capital gains arising from the transfer of capital asset by way of distribution of capital asset on the dissolution of firm or otherwise as per the provisions of section 45(4) read with section 2(14) of the Act.

12. The ld. D.R., at the outset, cited the cases of **CIT –vs. Bankey Lal Vaidya [79 ITR 595]** and **CIT, Madhya Pradesh –vs.- Dewas Cine Corporation [68 ITR 240]** decided by the Hon'ble Supreme Court in support of the Revenue's case and contended that the ratio of the said decisions relied upon by the Assessing Officer is squarely applicable in the facts of the present case. He took us through the relevant portion of the judgments delivered by the Hon'ble Supreme Court in the said cases and relied on certain observations and findings recorded by the Hon'ble

Supreme Court, which according to him, supported the revenue's case. He contended that the present case was a clear case of transfer of right in the land by the retiring partners to the continuing /incoming partners giving rise to the capital gain. He contended that the provisions of section 47(ii) have been omitted by the Finance Act, 1988 w.e.f. 01.04.1988 and keeping in view the said deletion as well as the definition of capital assets as contained in section 2(14), which is widest amplitude, even distribution of money equivalent to the retiring partner towards his share also falls within the ambit of transfer as defined under section 2(14) attracting the provisions of section 45(4) of the Act. He contended that the decision of the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)** and the decision of the Hon'ble Supreme Court in the case of **CIT –vs.- Bankey Lal Vaidya (supra)** relied upon by the ld. Accountant Member to decide the issue in favour of the revenue are very relevant and the same squarely cover the issue in favour of the revenue. He, therefore, strongly supported the order passed by the ld. Accountant Member and contended that the view taken by the ld. Accountant Member deserves to be endorsed.

13. The ld. Counsel for the assessee, on the other hand, contended that the decision of the Hon'ble Supreme Court in the case of **CIT –vs. Bankey Lal Vaidya [79 ITR 594]** relied upon by the Assessing Officer as well as by the ld. Accountant Member is found to be distinguishable on facts by the ld. Judicial Member. In this regard, he invited our attention to para nos. 18 & 19 of the order of the ld. Accountant Member to show the distinguishing features pointed out by the ld. Judicial Member while holding that the said decision of the Hon'ble Supreme Court is not applicable to the facts of the assessee's case.

14. As regards the decision of the Hon'ble Supreme Court in the case of **CIT, Madhya Pradesh –vs.- Dewas Cine Corporation (supra)** relied

upon by the Assessing Officer in the assessment order, the ld. Counsel for the assessee submitted that the same has not been cited by the ld. Accountant Member in his order. He took us through the judgment of the Hon'ble Supreme Court delivered in the said case to point out that the so-called observations of the Hon'ble Supreme Court as quoted by the Assessing Officer in paragraph no. 13.4.2 of the assessment order and relied upon to decide the issue against the assessee are actually not recorded anywhere in the judgment of the Hon'ble Supreme Court.

15. As regards the decision of the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)** strongly relied upon by the ld. Accountant Member to decide the issue against the assessee and in favour of the revenue, the ld. Counsel for the assessee contended that the same was not only found to be distinguishable on facts by the ld. Judicial Member for the reasons given in paragraphs no. 8 to 10 of his order, but a reference was also made by him in this regard to the decision of Full Bench of Hon'ble Karnataka High Court in the case of **Dynamic Enterprises (supra)** as well as the decisions of Coordinate Benches of the Tribunal in the case **Keshav & Co. (supra)** and **Mahul Corporation (supra)**, wherein the same was found to be distinguishable on facts. He contended that all these three cases relied upon by the ld. Judicial Member in support of the view taken by him involved similar facts and the ratio of the same has been rightly applied by the ld. Accountant Member to decide the issue in favour of the assessee. He contended that the decision of Full Bench of Hon'ble Karnataka High Court in the case of **Dynamic Enterprises (supra)** was cited on behalf of the assessee during the course of hearing before the Division bench in support of his case and even though the same was not found to be distinguishable on facts by the ld. Accountant Member, he proceeded to overlook the same and decided the issue against the assessee by relying on the decision of the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)**, which

involved a different set of facts as pointed out by the ld. Judicial Member in his order as well as by the Full Bench of the Hon'ble Karnataka High Court in the case of **Dynamic Enterprises (supra)**. He contended that similarly the decision of the Hon'ble Karnataka High Court in the case of **Kirloskar Asia Limited (supra)** was not relevant to decide the issue and reliance of the Hon'ble Accountant Member on the same is clearly misplaced. He contended that the decision of the Full Bench of Hon'ble Karnataka High Court in the case of **Dynamic Enterprises (supra)** as well as the decision of the Tribunal in the case of **Keshav & Co. (supra)** and **Mahul Corporation (supra)**, on the other hand, are directly applicable to the facts of the present case and the view taken by the ld. Judicial Member while deciding the issue in favour of the assessee by following the said judicial pronouncements is correct in law as well as on facts.

16. I have heard the rival submissions and also perused the relevant material available on record including two separate orders passed by the ld. Differing Members. I have also carefully gone through the various case laws referred to and relied upon in support of the respective views expressed by the ld. Differing Members. The assessee in the present case is a partnership firm, which was originally constituted vide the Deed of Partnership entered into on 01.08.2005 with the object to carry on the business of real estate development and construction. As already discussed in detail while narrating the facts, the said partnership firm was reconstituted from time to time. Meanwhile on 23.09.2005, the assessee-firm purchased a property at Village Juhu, Taluka Andhri, Greater Mumbai, admeasuring 14,022 sq.yd. for a consideration of Rs.6.5 crores. After arriving at a settlement with most of the tenants occupying the said property and obtaining permission of the concerned competent authority for construction of a five-star hotel, the said property was revalued at Rs.193,90,60,000/- as per the valuation report dated

25.03.2006 prepared by Shri A.R. Nigam, a Registered Valuer. The resultant revaluation surplus was credited to the capital accounts of the partners in their profit sharing ratio and accordingly a sum of Rs.30,87,98,087/- each came to be credited to the capital accounts of the two partners namely Smt. Hemlata Shetty and Shri Sudhakar Shetty having 20% profit share each. Thereafter Smt. Hemlata Shetty retired from the partnership firm on 27.03.2006 while Shri Sudhakar Shetty retired from the partnership firm on 22.05.2006. On their retirement, both these partners were paid the amounts standing to the credit of their capital accounts in the partnership firm including the amount of Rs.30,87,98,087 credited on account of revaluation surplus. The question that has arisen and which is referred to the Third Member is whether, in these facts and circumstances of the case, the money equivalent to enhanced portion of the assets revalued constitutes capital asset and whether there was any transfer of such capital asset on dissolution of firm or otherwise within the meaning of section 45(4) read with section 2(14).

17. The provisions contained in section 45 deal with capital gains and sub-section (4) thereof being relevant in the present context is extracted below:-

> *"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 cooperative 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".*

18. The purpose of inserting sub-section (4) in section 45 of the Income Tax Act, 1961 by the Finance Act, 1987 w.e.f. 1st April, 1988 is explained

in the explanatory notes on the provisions of the Finance Act 1987 vide the CBDT Circular No. 495 dated 22.09.1987. As explained by the CBDT, the conversion of partnership assets into individual assets on dissolution or otherwise was being used as the scheme of tax avoidance and accordingly new sub-section (4) was inserted in section 45 so as to make the profit or gains arising from the transfer of capital asset by a firm to a partner on dissolution or otherwise chargeable as the firm's income in the previous year in which the transfer took place. Prior to insertion of sub-section (4) in section 45 w.e.f. April 1st, 1988, the position was governed by Clause (ii) of section 47 whereby the transfer of capital assets by way of distribution of capital assets on the dissolution of a firm was not regarded as transfer and the provisions of section 45 were not applicable. As a consequential measure, Clause (ii) of Section 47 was omitted by the Finance Act, 1987 w.e.f. April 1, 1988.

19. In the 1922 Act, the provisions dealing with capital gains were contained in section 12B(1) and the same read as under:-

> *"The tax shall be payable by an assessee under the head 'capital gains' in respect of any profits or gains arising from the sale, exchange or transfer of a capital asset effected after the 31st day of March, 1946.....and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange or transfer took place.....*
> *Provided further that any transfer of capital assets.....on the dissolution of a firm or other association of persons.....shall not, for the purposes of this section, be treated as sale, exchange or transfer of the capital assets".*

20. The case of **Bankey Lal Vaidya (supra)** relied upon in support of the revenue's case involving assessment year 1947-48 came to be considered by the Hon'ble Supreme Court in the context of section 12B(1) of 1922 Act. In the said case, the assessee, who was the Karta of a Hindu undivided family, entered on behalf of the HUF into a partnership firm

with one Devi Sharan Garg to carry on the business of manufacturing and selling pharmaceutical products and literature relating thereto. On July 27, 1946, the partnership firm was dissolved and the assets of the firm including goodwill, machinery, furniture, medicines, library and copyright in respect of certain publications were valued on the date of dissolution at Rs.2,50,000/-. The assessee was paid a sum of Rs.1,25,000/- in lieu of his share and the business together with goodwill was taken over by Shri Devi Saran Garg. The question that arose before the Hon'ble Supreme Court was whether, on a true interpretation of sub-section (1) of section 12B of the Income Tax Act, 1922, the assessee was liable to pay capital gains and while answering the same in the negative and in favour of the assessee, the Hon'ble Supreme Court held that there was no sale or exchange of his share in the capital asset of the firm by the assessee to Shri Devi Saran Garg nor did he transfer his share in the capital assets. It was held that the assets of the firm included the goodwill, machinery, furniture, medicines, library and the copyright in respect of certain publications and since a large majority of the said assets were incapable of physical division, the partners agreed that the assets be taken over by Shri Devi Sharan Garg at a valuation and the assessee be paid his share of the value in money. It was held that such an arrangement amounted to a distribution of the assets of the firm on dissolution and the payment of the agreed amount to the assessee under the arrangement of his share was, therefore, not in consequence of any sale, exchange or transfer of assets. In the present case, the facts involved however, are different, inasmuch as, there is no dissolution of the partnership firm and since the property in question was continued to be owned by the assessee-firm even after the retirement of two partners namely Smt. Hemlata Shetty and Shri Sudhakar Shetty, it is not a case of transfer of the said property by way of distribution of capital assets on dissolution or otherwise. In the case of **Bankey Lal Vaidya (supra)**, the partnership firm was not only dissolved but one of the partners namely

Shri Devi Sharan Garg had taken over all the assets of the firm in his individual capacity for an agreed consideration of Rs.2,50,000/- and the assessee was paid a fixed sum in lieu of his share in the business together with the goodwill that was taken over by Shri Devi Sharan Garg. It is pertinent to note here that the money equivalent paid to the partner in lieu of his share in the assets of the firm taken over by other partner on dissolution was never treated as constituting a capital asset. Moreover, the question of taxability of capital gain was involved in the case of a partner under section 12B(1) of the 1922 Act and not in the case of a partnership firm as envisaged in section 45(4) of the Income Tax Act, 1961.

21. In the case of **Dewas Cine Corporation (supra)** relied upon in support of the revenue's case, Shri S.G. Sanghi and Shri Hari Prasad entered into an agreement to carry on the business in partnership as exhibitors of cinematograph films in the name and style of "Dewas Cine Corporation" with effect from March 1, 1947. Each partner, who was an owner of a cinematograph theatre, brought his theatre into the books of the partnership as an asset of the partnership. For the assessment years 1950-51 to 1952-53, the Income Tax Officer allowed depreciation aggregating to Rs.44,380/- in respect of the two theatres. The partnership was dissolved on September 30, 1951 and on dissolution, it was agreed between the partners that the theatres should be returned to their original owners. In the books of account maintained by the partnership, the assets were shown as taken over on October 1, 1951, at the original price less the depreciation allowed. In the proceedings for assessment years 1952-53, the assessee-firm was treated as a registered firm and it was held that by restoring the two theatres to the two original owners, there was a transfer by the firm and the entries adjusting the depreciation and writing off the assets at the original value amounted to total recoupment of the entire depreciation by the partnership firm

attracting proviso 2 to section 10(2)(vii) of the Income Tax Act, 1922. The question that arose for the consideration of the Hon'ble Supreme Court was whether, on the facts and in the circumstances of the case, the amount of Rs.44,380/- was rightly included in the total income of the assessee in the year 1952-53 under the second proviso to section 10(2)(vii) of the Income Tax Act, 1922 and while answering the same in the negative and in favour of the assessee, Hon'ble Supreme Court relied on the provisions of the Partnership Act, 1932 to hold that when the two partners had brought in the theatres of their respective ownership into the partnership, the theatres must be deemed to have become the property of the partnership. It was held that under section 46 of the Partnership Act, 1932, on the dissolution of the firm, every partner or his representative was entitled to have the property of the firm applied in payment of the debts and liabilities of the firm, and to have the surplus distributed among the partners or their representatives according to their rights. It was held that the distribution surplus was for the purpose of adjustment of the rights of the partners in the assets of the partnership and it did not amount to transfer of assets. The issue involved in the case of **Dewas Cine Corporation (supra)** thus was entirely different and the decision rendered by the Hon'ble Supreme Court in the said case was in a different context than the one involved in the present case.

22. In the case of **CIT -vs.- Mohanbhai Pamabhai (91 ITR 393)**, the assessees and seven other partners had carried on the business of manufacturing Mangalore tiles in partnership in the name of Prajapati Tiles Company. The said business was being carried on by the firm ever since its inception on 13th January, 1953. There were disputes between the partners of the firm as a result of which the assessees retired from the firm w.e.f. 18.02.1962, leaving the other seven as continuing partners of the firm. On retirement, each retiring partner received a certain amount in respect of his share in the partnership and this amount was

worked out by taking the proportionate value of share in the net partnership assets after deduction of liabilities and prior charges. The amount so received also included in its break-up an amount representing proportionate share in the value of goodwill. The Assessing Officer took a view that the amount received by the assessees to the extent it included their proportionate share in the value of the goodwill represented capital gain chargeable to tax under section 45 of the Income Tax Act, 1961. The assessees disputed this view taken by the Assessing Officer in the appeal filed before the first appellate authority and being unsuccessful, filed a further appeal to the Tribunal. Before the Tribunal, two contentions mainly were advanced on behalf of the assessees. The first contention was that the retirement of the assessees from the partnership amounted to dissolution of the firm within the meaning of section 47, clause(ii), and, therefore, no transfer of capital asset chargeable to tax under section 45 was involved in the process by which the goodwill of the firm was taken over by the remaining seven partners and the proportionate share in the value of the goodwill was paid to each of the retiring partners. This contention was negatived by the Tribunal by taking a view that the present case was a case of retirement of four partners from the firm and not a case of dissolution which would attract the applicability of section 47 of clause (ii). The second contention raised on behalf of the assessee, however, found favour with the Tribunal and that contention was that goodwill was a self-created asset which had cost nothing to the firm and its partners in terms of money and a transfer of it was, therefore, not within the ambit of the charging provision contained in section 45 and the proportionate share in the value of the goodwill received by each assessee for transfer of his interest in the goodwill was not taxable as capital gain.

23. Dissatisfied with the decision of the Tribunal in so far as it went against it in the case of **CIT –vs.- Mohanbhai Pamabhai (supra)**, the

Revenue carried the matter before the Hon'ble Gujarat High Court. The following two questions were referred to the Hon'ble Gujarat High Court:-

> *(i) Whether the Tribunal was right in holding that the goodwill of the firm is a self-acquired asset of the firm?*
>
> *(ii) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the amount received by the assessee by way of his share in the goodwill of the first is not liable to be assessed to tax?*

The following third question was also referred to the Hon'ble Gujarat High Court at the instance of the assessee:

> *(iii) Whether on the facts and in the circumstances of the case, the retirement of the assessee as partner from the firm amounted to dissolution of the firm, and, therefore, the capital gain, if any, is chargeable to tax in view of the provisions of section 47(ii) of the Act?*

It is pertinent to note that the Hon'ble Gujarat High Court decided the questions no. 1 & 2 referred to it in the affirmative and in favour of the assessee and consequently did not consider it necessary to answer question no. 3. The decision of the Hon'ble Gujarat High Court rendered while deciding the questions no. 1 & 2 as involved in the case of **Mohanbhai Pamabhai** was upheld by the Hon'ble Supreme Court in 165 ITR 166. It is thus clear that the issue in the context of section 47(ii) relating to the transfer of capital asset by way of distribution of capital assets on dissolution or otherwise was not decided in the case of Mohanbhai Pamabhai and the reliance on the same in support of the revenue's case on the issue under consideration is clearly misplaced. The Hon'ble Supreme Court in the case of **Tribhuvandas G. Patel (supra)** followed the decision of **Mohanbhai Pamabhai (supra)**. It is relevant to mention here that all these judgments cited on the issue were previous to the amendment brought about by the Finance Act, 1987 by inserting sub-section (4) in section 45 w.e.f. 01.04.1988 and it is therefore necessary to

examine the issue in the light of amended provisions which has brought about a change in the position of law on the point for income tax purpose.

24. In the case of **A.N. Naik Associates (supra)** which is heavily relied upon by the Assessing Officer as well as by the ld. Accountant Member in support of the revenue's case, the decision was rendered in the context of section 45(5) of the Act, 1961. It is interesting to note that even the ld. CIT(Appeals) in his impugned order has relied on the said decision of the Hon'ble Bombay High Court to decide the matter in favour of the assessee while the ld. Judicial Member has found the said case to be distinguishable on facts.

25. The assessees in the case of **A.N. Naik Associates (supra)** were parties to a family settlement dated January 30, 1997, pursuant to which there was a deed of reconstitution of various partnerships. For the assessment year 1997-98, the partnerships were taxed for capital gains under section 45(4) of the Income Tax Act, 1961. When this action of the Assessing Officer was confirmed by the first appellate authority, the assessee preferred an appeal before the Tribunal. The Tribunal allowed the said appeal by holding that there was no dissolution of the partnership firm but only reconstitution. The Tribunal also held that the expression "otherwise" used in section 45(4) had to be read *ejusdem generis* and would contemplate situations like a deemed dissolution. It was also held by the Tribunal that the business of the partnership firm continued to be run and there being no dissolution of the firm, section 45(4) of the Act was not attracted. Against the orders of the Tribunal, the Revenue went in appeal before the Hon'ble Bombay High Court raising inter alia the following questions of law:-

> *"(1) Whether the deed of family settlement dated January 30, 1997, amounts to dissolution of partnership formed by agreement as contemplated under section 40 of the Indian Partnership Act?*

(2) Whether the distribution of assets of the firm amongst the retiring partners dated January 30, 1997, and the deed of reconstitution dated January 30, 1997, would amount to transfer of the capital assets which is in the nature of capital gains and business profits chargeable to tax under section 45(4) of the Income Tax Act?

(3) Whether the word 'otherwise', in section 45(4) takes into its sweep not only cases akin to dissolution of the firm but also cases of reconstitution of firm?

26. While deciding the questions referred to it, the Hon'ble Bombay High Court first took note of the fact that by the memorandum of family settlement dated January 30, 1997, it was agreed between the parties thereto, that business of six firms as set out therein would be distributed in terms of the family settlement as the parties desired that various matters concerning the business and assets thereto be divided separately and partitioned. Under the terms and conditions of the settlement, it was set out that the assets which were proposed to be divided in partition under the settlement were held by the aforesaid firms and individual partners. With reference to the firms, the manner in which the firms were to be reconstituted by retirement and admission of new partners was also set out. It was also noted that such of those assets or liabilities belonging to or due from any of the firms allotted to parties thereto in the schedule annexed shall be transferred or assigned irrevocably and possession made over and all such documents, deeds, declarations affidavits, petitions, letters and alike as were reasonably required by the party entitled to such transfer would be effected. After taking note of this factual position, the Hon'ble Bombay High Court referred to section 45(4) and proceeded initially to answer the question no. 1. It was held in this context by the Hon'ble Bombay High Court that the partnership firm having subsisted and the business also continued, there was no dissolution of the partnership firm and the decision of the Tribunal to that effect could not be faulted. Hon'ble Bombay High Court then proceeded to answer questions no. 2 & 3 together with question no. 5 and noted that the various judgments cited on the issue were previous to the

amendment brought about by the Act of 1987 by introducing sub-section (4) in section 45 w.e.f. April 1, 1988. It was noted that all those judgments proceeded on the footing that a partnership firm is not a distinct legal entity and the partnership property in law belongs to all the partners constituting the firm, and the consequence of distribution, division or allotment of assets of the partners which flows upon dissolution after discharge of liabilities is nothing but a mutual adjustment of rights between the partners, which cannot be regarded as a transfer of assets within the meaning of section 2(47) of the Act. Hon'ble Bombay High Court then proceeded to examine the position in the context of the law as amended after 1988 and held that on retirement of a partner or partners of an existing firm, who receives assets of the firm, the law before 1988 would really of no support as by section 45(4), what was otherwise not taxable has been made taxable. It was held that if the object of insertion of sub-section 4 of section 45 is seen and the mischief it seeks to avoid, it would be clear that the intention of Parliament was to bring into the tax net transactions whereby assets were brought into a firm or taken out of the firm. It was held that the expression 'otherwise' has not to be read ejusdem generis with the expression "dissolution of a firm or body or association of persons" and the same has to be read with the words "transfer of capital assets" by way of distribution of capital assets. Consequently it was held that even when a firm is in existence and there is a transfer of capital asset, it comes within the expression "otherwise" as the object of the amending Act was to remove the loophole which existed whereby capital gain tax was not chargeable. It was accordingly held that when the asset of the partnership is transferred to a retiring partner, the partnership which is assessable to tax ceases to have a right or its right in the property stands extinguished in favour of the partner to whom it is transferred and the provisions of section 45(4) would be applicable.

27. A careful study of the judgment of the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)** shows that the facts involved in the said case were materially different from the facts involved in the present case, inasmuch as, the assets of the partnership firm in the said case were transferred to the retiring partners and the partnership firm, which was assessable to tax, had ceased to have a right or its right in the property stood extinguished in favour of the partner to whom it was transferred. Keeping in view this factual position that existed in the case of **A.N. Naik Associates (supra)**, Hon'ble Bombay High Court held that there was a transfer of capital assets by way of distribution of assets even though the partnership firm continued to exist and there was no dissolution as the case was covered within the expression "otherwise" used in section 45(4). In the present case, the facts involved are materially different, inasmuch as, the partnership firm not only continued to exist after reconstitution without there being any dissolution, but the property also continued to be owned by the said firm without any extinguishment of rights in favour of the retiring partners. There was thus no transfer of the said property even within the meaning of expression "otherwise" used in section 45(4). It is thus clear that the facts involved in the case of **A.N. Naik Associates (supra)** were materially different from the facts involved in the present case as rightly observed by the Id. Judicial Member and the proposition propounded therein by the Hon'ble Bombay High Court that the expression "otherwise" used in section 45(4) has to be read with the words "transfer of capital assets" by way of distribution of capital assets supported the case of the assessee on the issue under consideration as there was no transfer of capital assets by the partnership firm to the retiring partners even after the reconstitution and the partnership firm continued to remain the owner of the property.

28. In support of the view taken in favour of the assessee on the issue under consideration, the ld. Judicial Member has placed a heavy reliance on the judgment of Full Bench of the Hon'ble Karnataka High Court in the case of **CIT –vs.- Dynamic Enterprises (supra).** As rightly observed by him, the facts involved in the said case are identical to the facts involved in the present case. The assessee in the said case was a partnership firm, which had come into existence on 09.01.1985 with Shri Anurag Jain and Sri Nirmal Kumar Dugar as its partners. The said firm was engaged in the business of buying landed properties, constructions of buildings thereon, construction of industrial sheds, commercial complexes etc. On 13.04.1987, the firm was reconstituted by which Shri Nirmal Kumar Dugar retired from the partnership firm and Shri L.P. Jain, father of Anurag Jain, entered as a partner. The firm purchased land at Jakkasandra Village, Begur Hobli, Bangalore South Taluk under a registered sale deed dated 13.05.1987 for a consideration of Rs.2,50,000/-. Another reconstitution took place on 1.7.1991 by which Shri L.P. Jain retired from the firm and Smt. Pushpa Jain and Smt. Shree Jain were inducted as partners. The partnership firm again was reconstituted and five partners belonging to Khemka Group were inducted into the firm by a deed dated 28.04.1993. Before the said reconstitution, the assets of the firm were revalued as per the report of the registered valuer on 28.03.1993. Thereafter the three old partners retired through deed of retirement dated 01.04.1994 and received the enhanced value of property in financial year 1994-95. This reconstitution whereby the new partners were introduced and the old partners were retired was treated by the Assessing Officer as a device adopted by the assessee to evade capital gains tax as well as stamp duty. He held that there was a transfer of property from old firm to new firm on 01.04.1994 on which capital gains tax was payable. The first appellate authority upheld the view taken by the Assessing Officer. On further appeal by the assessee, the Tribunal held that as per section 45 of the Income Tax Act, profit and gains arising

from the transfer of a capital asset is chargeable under the head "capital gains" and hence to levy capital gains tax, there should be an asset and there should be transfer in respect of that asset. The Tribunal referred to the definition of "transfer" given in section 2(47), which includes sale, exchange or relinquishment of the asset as well as extinguishment of any rights in the asset. The Tribunal held that the assesee-firm had not relinquished any right in the land and the said land being continued to be owned by the firm, the reconstituted firm could not be termed as a transferor even for the arguments sake. It was held that there was thus no transfer of land and the firm was not liable to pay capital gains tax. The order of the Tribunal was challenged by the revenue in the appeal filed before the Hon'ble Karnataka High Court. The Hon'ble Karnataka High Court initially considered the relevant position under the Indian Partnership Act, 1932 and after discussing the relevant judgments on the point, held that it is the partners who own jointly 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 partners and there is no question of any extinguishment of the firm's rights in the partnership assets. Hon'ble Karnataka High Court noted that the Indian Income Tax Act, however recognizes the firm as a distinct assessable legal entity apart from its partners and proceeded to examine the position with reference to sub-section (4) of section 45 introduced by the Finance Act, 1987 with effect from 01.04.1988.

29. After analysing the provision of section 45(4) of the Act, Hon'ble Karnataka High Court held that the following conditions are precedent in order to attract sub-section (4) of section 45:-

(i) There should be a distribution of capital assets of the firm;

(ii) Such distribution should result in transfer of capital asset by firm in favour of the partner; and

(iii) Such distribution should be on dissolution of the firm or otherwise.

On the basis of the above analysis, it was held by the Hon'ble Karnataka High Court that in order to attract section 45(4) of the Act, the capital asset of the firm should be transferred in favour of a partner, resulting in firm ceasing to have any interest in the capital asset transferred and the partners should acquire exclusive interest in the capital asset. It was held that the interest the firm has in the capital asset should be extinguished and the partners in whose favour the transfer was made should acquire that interest so as to attract the provisions of section 45(4). It was observed by the Hon'ble Karnataka High Court that in the case before it the partnership being continued to exist even after the retirement of three partners, there was neither dissolution of the firm nor even the distribution of capital asset on 01.04.1994 when the three partners retired from the partnership firm. As noted by the Hon'ble Karnataka High Court what was given to the retiring partners was cash representing their value in the partnership and there was no transfer of any capital asset on the date of retirement under the deed of retirement dated 01.04.1994. It was held that in the absence of distribution of capital asset and in the absence of transfer of capital asset in favour of the retiring partners, the question of the payment being assessed under section 45(4) would not arise. It was held that when the retiring partners took cash and retired, what they relinquished was their share in the partnership and there being no transfer of capital asset, section 45(4) had no application to the facts of the case.

30. In the case of **Gurunath Talkies (supra)** decided earlier, the Division Bench of the Hon'ble Karnataka High Court had taken a contrary view in favour of the revenue and against the assessee on the similar

issue by following the judgment of the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)** and while dealing with the same in its judgment passed in the case of Dynamic Enterprises (supra), the Full Bench of the Hon'ble Karnataka High Court found that the facts involved in the case of **A.N. Naik Associates (supra)** decided by the Hon ble Bombay High Court were altogether different. As noted by the Full Bench of the Hon'ble Karnataka High Court in this context, the assets of the partnership firm in the case of **A.N. Naik Associates** were transferred to the retiring partners by way of deed of retirement as per the Memorandum of Family Settlement entered into and when the assets of the partnership firm were transferred to the retiring partners, the partnership which was assessable to tax, had ceased to have a right or rights in the property stood extinguished in favour of the partner to whom it was transferred. As observed by the Hon'ble Karnataka High Court, it was in this context the Hon'ble Bombay High Court held that the word "otherwise" takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of a retiring partner. The Hon'ble Karnataka High Court laid emphasis on the observations recorded by the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)** to the effect that to attract section 45(4), there should be a transfer of a capital asset from the firm to the retiring partners, by which the firm ceases to have any right in the property, which was so transferred and its right to the property stands extinguished and the retiring partners acquire absolute title of the property. The Hon'ble Karnataka High Court took note of the fact that the partnership firm in the case of Dynamic Enterprises did not transfer any right in the capital asset in favour of the retiring partners and since its right to the property was not extinguished and the retiring partner did not acquire any right in the property, held that the facts involved were materially different from the facts involved in the case of **A.N. Naik Associates (supra)**. It was held by the Full Bench of the

Hon'ble Karnataka High Court that its Division Bench while deciding the **Gurunath Talkies case** did not appreciate this distinguishing factors and the judgment passed in the case of Gurunath Talkies by wrongly applying the law laid down by the Hon'ble Bombay High Court in the case of **A.N. Naik Associates (supra)** did not lay down the correct law. Accordingly it was held by the Full Bench of the Hon'ble Karnataka High Court in the case of **Dynamic Enterprises (supra)** that when a retiring partner takes only money towards the value of his share and when there is no distribution of capital asset/assets among the partners, there is no transfer of a capital asset and consequently no profits or gains is chargeable to tax under section 45(4) of the Income Tax Act, 1961.

31. It is observed that a similar issue was also decided in favour of the assessee by Hon'ble Kerala High Court in the case of **CIT -vs.- Kunnamkulal Mill Board (257 ITR 544)** involving identical facts. In the said case, the assessee was a partnership firm. It had originally five partners and it was constituted under a Deed executed on 14.09.1983. Subsequently there was a change in the constitution of the partnership as evidenced by a new Partnership Deed executed on January 13, 1989. Two more partners were admitted at that time. At the time of admission of the new partners, there was a revaluation made in respect of the assets of the firm. As per clause 6 of the partnership deed, it was agreed that the difference representing enhancement by revaluation of the assets would be credited to the accounts of the original partners and the two new partners would have no share in it. The partnership firm continued with seven partners for a short time and thereafter on January 31, 1989, the original five partners retired and the business was continued by the partnership consisting of the surviving two partners. As per the deed of retirement executed on January 31, 1989, the retiring partners were entitled to the credit balances in their accounts with the firm. The Assessing Officer took the view that the retirement of five partners taking

the enhanced value for the assets amounted to a transfer of capital assets as envisaged in section 45(4) and the profit arising from the transfer was liable to tax as the income of the assessee-firm. In the appeal filed by the assessee, the first appellate authority held that the provisions of section 45(4) were not applicable in the case as there was neither a dissolution of the firm nor distribution of capital assets when the partners retired from the firm. The Tribunal confirmed the order of the first appellate authority and the question that arose for the consideration of Hon'ble Kerala High Court in the appeal filed by the revenue under section 260A of the Act was "whether, on the facts and in the circumstances of the case, the Tribunal was right in law and facts in holding that the provisions of section 45(4) had no application to the facts of the case and that the addition could not be sustained under that section", After considering the relevant provisions of the law as well as the case laws on the point, Hon'ble Kerala High Court held that there was no change in the status of the assessee-firm even on the retirement of the five partners and there was no change in the ownership of the property even with the change in the constitution of the firm. It was held that as long as there was no change in ownership of the firm and its properties, there was no transfer of capital assets. It was held that there was thus no transfer of assets within the meaning of section 45(4) of the Act on the reconstitution of the partnership firm and the addition made by applying section 45(4) was not sustainable.

32. It is no doubt true that the term "capital asset" is very widely defined in section 2(14) to include property of any kind and as held by Hon'ble Delhi High Court in the case of **PNB Finance Ltd. (supra)**, the said all inclusive definition of the 'capital asset' brings within its ambit property of any kind held by the assessee. In this regard, reliance is placed in support of the revenue's case on the decision of Hon'ble Karnataka High Court in the case of **Kirloskar Asea Limited (117 ITR**

82). In the said case, the assessee was a Public Limited Company registered under the Indian Companies Act and carrying on business at Bangalore. It had entered into a collaboration agreement on August 21, 1964, with Alimanna Svenska Elektriska Aktiebolaget (in short 'ASEA'). The said foreign collaborator contributed towards the share capital of the assessee-company a sum of Rs.12,00,000/-. This sum was paid in terms of dollars and credited to the accounts of the assessee maintained in Swedish Bank for the purpose of acquiring machinery. The assessee, however, could use only a part of the said amount for purchase of imported machinery and the balance amount lying in the Swedish Bank in foreign exchange was repatriated by the assessee to India with the permission of the Reserve Bank of India during the relevant year. When the dollars in question were acquired in or about the year 1964, a dollar was worth Rs.4.76 but on account of devaluation of the Indian rupee which took place on June 6, 1966, the value of dollar in terms of rupee had gone up on the date of repatriation to Rs.7.50. Consequently the assessee in terms of rupee got Rs.2,98,657/- more than what it would have got had the foreign currency in question been repatriated at the time of its acquisition. The Income Tax Officer treated the sum of Rs.2,98,657/- as long-term capital gain and brought it to tax under the provisions of the Act. The first appellate authority as well as the Tribunal confirmed the addition made by the Assessing Officer and the question that arose before the Hon'ble Karnataka High Court was "whether, on the facts and in the circumstances of the case, a sum of Rs.2,98,657/- was rightly assessed as 'long-term capital gain'". While answering the said question in the affirmative and in favour of the revenue, Hon'ble Karnataka High Court held that the dollars in question, which were repatriated to India, being the property of the assessee, constituted capital asset of the assessee within the meaning of section 2(14) of the Act and any profit derived on account of its transfer was liable to be treated as capital gain as the assessee was able to acquire Indian

currency only by transferring the capital asset as defined in section 2(47) of the Act. The facts involved in the present case, however, are entirely different from the facts involved in the case of **Kirloskar Asea Limited (supra)** and the money equivalent to enhanced portion of the assets revalued and paid by the assessee-firm to the retiring partners cannot be equated with the foreign exchange acquired and realised at a higher value in terms of rupee as involved in the case of **Kirloskar Asea Limited (supra)** so as to say that it constitutes capital assets for the purpose of section 45(4) read with section 2(14) of the Act. Moreover, the money equivalent to enhanced portion of the assets revalued and paid by the assessee firm to the retiring partners cannot be treated by any stretch of imagination, as the capital asset held by the assessee firm.

33. To summarise, I am of the view that the partnership firm in the present case continued to exist even after the retirement of Smt. Hemlata Shetty and Shri Sudhakar Shetty from the partnership on 26.03.2006 and 25.05.2006 respectively. There was only a reconstitution of partnership firm on their retirement without there being any dissolution and the land properly acquired by the partnership firm continued to be owned by the said firm even after reconstitution without any extinguishment of rights in favour of the retiring partners. The retiring partners did not acquire any right in the said property and what they got on retirement was only the money equivalent to their share of revaluation surplus (enhanced portion of the asset revalued) which was credited to their capital accounts. There was thus no transfer of capital asset by way of distribution of capital asset either on dissolution or otherwise within the meaning of section 45(4) read with section 2(14) of the Act. I also hold that the money equivalent to enhanced portion of the assets re-valued does not constitute capital asset within the meaning of section 2(14) and the payment of the said money by the assessee-firm to the retiring partners cannot give rise to capital gain under section 45(4) read with

section 2(14) of the Income Tax Act, 1961. I accordingly agree with the view taken by the ld. Judicial Member and answer both the question referred under section 254(4) of the Act in the negative and in favour of the assessee.

34. In the light of the above discussion, the matter may now be placed before the regular bench for an appropriate order, in accordance with law.

Sd/-

(P.M. JAGTAP)
Vice-President (KZ)
10/01/2019