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Burlingtons' Exports Vs. Assistant Commissioner Of

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Nov-26-1992

Reported in : (1993)45ITD424(Mum.)

Judge : O Jain, R Garg

Appellant : Burlingtons' Exports

Respondent : Assistant Commissioner Of

Judgement :

1. These two appeals are by the assessee against the orders of the CIT (Appeals), for the assessment years 1988-89 and 1989-90. For the sake of convenience, both the appeals are being disposed of by this common order.

2. In the appeal for the assessment year 1988-89, the first ground is against the assessment of a sum of Rs. 1,47,80,403 as short-term capital gains. On scrutiny of the assessee's accounts, the Assessing Officer noticed that till last year, the assessee was holding two properties (i) bungalow No. 8 at Grand Paradi, Kamps Corner, Bombay, occupied by one of the partners, Sri N.R. Kapur and (ii) a flat at Beach Candy Apartment, occupied by another partner Sri R.K.A. Kapur.

The written down values of both the properties were Rs. 3,90,230 and Rs. 1,36,867 respectively. These two properties were claimed to have been transferred on 7-10-1986 to the respective occupant partners. The Assessing Officer asked the assessee to show cause why the provisions of Section 45(4) of

the Income-tax Act, 1961, be not applied. The assessee submitted that this section applies only when there is a dissolution of partnership and in the present case, there was neither dissolution nor transfer, inasmuch as the properties stood in the respective names of the two partners and it was a case of simple withdrawal. The Assessing Officer held that the transaction was covered by the words "or otherwise" appearing in Section 45(4) of the Act, even if there was no dissolution of the firm. He also observed that originally the firm was consisting of these two partners since 20-12-1979. Sri N.R. Kapur retired from the firm on 30-3-1987 but before that the wife of Sri R.K.A. Kapur, the other partner, namely, Mrs. Sunita was introduced as partner on 7-3-1987. Referring to Clause 8 of the partnership deed, the Assessing Officer noted that to retire, a partner was to give three months' notice. Sri N.R. Kapur retired on 30-3-1987 which, according to him, showed that all these persons knew that Sri N.R. Kapur was retiring and Mrs. Sunita was introduced to avoid legal dissolution. He further stated that there was no evidence for the alleged transfer of the properties to the two partners in October 1986. According to him the transfer followed by the retirement suggested a clear case of dissolution of the firm. Mrs. Sunita was an employee for a long period and even after becoming a partner, she was not prepared to forego her right to salary. This, according to him, showed that she was introduced only to avoid the application of the provisions of Section 45(4) of the Act. He further observed that for income-tax purposes, the partnership of husband and wife is of no benefit but, in spite of that, the assessee was prepared to pay the firm's tax and tax on clubbing of income under Section 64 of the Act.

Even otherwise, the income was going to their family, with or without her introduction as a partner. Therefore, the Assessing Officer concluded that the decision of the Supreme Court in the case of McDowell & Co. Ltd. v. CTO [1985] 154 ITR 148 was applicable to the facts of the case. The agreement dated 7-3-1988, he held, was a colourable device and the deed dated 30-3-1978 (wrongly typed as 30-3-1979) by which Sri N.R. Kapur retired suggested the dissolution of the firm and, therefore, the provisions of Section 45(4) of the Act applied. Working out the market value of the property at the rate of Rs. 2,500 per sq.ft. for Beach Candy and at the rate of Rs. 3,000 per sq.ft. for Grand Paradi, the Assessing Officer determined the market, value of the two properties at Rs. 1,53,07,500 and

reducing therefrom the written down value of the two flats at Rs. 5,27,097, he determined the capital gains assessable under Section 45(4) of the Act, at Rs. 1,47,80,403. The claim of the assessee for the application of Rule 1BB of the Wealth-tax Rules for determining the market value and the valuation based on rent capitalisation was rejected by him as, according to him, the partners could not be lessees of the firm and the firm a lessor of the firm. The partners, according to him, were the owners and, therefore, the amount credited as rent was not really rent nor could it change the real position of ownership. The partners could never be the tenants as per the Rent Control Act. He, therefore, concluded that the attempt of the assessee to treat it as a rent for the purpose of valuation was an attempt to defraud the revenue.

Applying the principles laid down by the Supreme Court in the case of R.C. Coopar, (sic) the market value was determined by him as if it were a vacant property occupied by the owner without any protection of the Tenancy Act.

3. In appeal, the CIT (Appeals) upheld the order of the Assessing Officer. Firstly, he noted that the two properties were purchased in the names of the individual partners and from the very beginning, the assessee-firm used to pay society and other charges and also used to charge each of the partners a monthly compensation of Rs. 1,950 and Rs. 900 respectively. He also noted the fact that Vijaya Bank has treated these properties as owned by the partners while giving loan to the assessee-firm on security thereof. After the withdrawal of these flats, the assessee-firm stopped charging rent and paying society and other charges and thereafter, the partners started paying these charges directly. Then, he narrated the assessee's submissions, (i) that the provisions of Section 45(4) of the Act did not apply to the transactions occurring prior to 31-3-1987; (ii) that there was no transfer either on dissolution or otherwise as the flats were merely withdrawn from the firm on 7-10-1986 and Sri N.R. Kapur retired on 30-3-1987; (iii) that there was no transfer on dissolution on retirement; (iv) that the previous year in which the transfer took place was the financial year 1986-87 relevant to the assessment year 1987-88 at which time, the provisions of Section 45(4) of the Act were not on the statute; (v) that the decision of the Supreme Court in the case of McDowell & Co. Ltd. (supra) was not applicable as the provisions of Section 45(4)

of the Act were not on the statute book when the transaction took place; and (vi) that the value adopted by the Assessing Officer was arbitrary and exhorbitant and should have been arrived at as per the provisions of Rule 1BB of the Wealth-tax Rules.

Disagreeing with these submissions, he held that the bungalow/flat belonged to the assessee-firm even though they stood in the name of the partners. They were shown in the balance-sheet of the firm; depreciation was being charged thereon by the firm; rent was being charged and society and other charges were being paid by the firm. He concluded that there was a transfer on withdrawal of the flat and bungalow by the partners. Whatever be the terminology used, according to him, the firm ceased to be the owner and the partners were vested with the ownership thereof from a particular date. Such a transaction, according to him, would be covered either as 'relinquishment of the asset' or "the extinguishment of assessee's rights therein"; or both.

He further held that the words "or otherwise" used in Section 45(4) of the Act, cover such transactions. Examining the matter a little deeper, the CIT (Appeals) held that the whole sequence of events of transferring/withdrawing the two properties on 7-10-1986, introducing the wife of one of the partners in the firm in March 1987; and then the other partner withdrawing his name from the firm, suggested that all this was done with a view to avoid the incidence of capital gains tax, as provided under Section 45(4) of the Act. He agreed with the Assessing Officer that there was no evidence for the claim of transfer of these two properties on 7-10-1986, except the book entries. The evidence in the form of a letter dated 27-10-1986 from Grand Paradi Co-op. Housing Society Limited and zerox copy of the share certificate in the name of R.K.A. Kapur and Naveen Roy Kapur were found to be not material. These were also not admitted by him as they were not filed before the Assessing Officer even though they existed with the assessee-firm. As regards the previous year, he held that the assessee itself has not shown this source of income in the return and, therefore, it was presumed to have no separate previous year than the previous year adopted for income from business. On valuation aspect, the CIT (Appeals) held that Rule 1BB of the Wealth-tax Rules could not be applied to income-tax proceedings as the proceedings under wealth-

tax and estate duty were altogether different. The provisions of Rule 1BB were a sort of concession given to the tax-payers like the provisions contained in Section 7(4) of the Wealth-tax Act and, therefore, he held, could not be equated with the principles determining the market value. He demonstrated the absurd results by adopting the provisions of Rule 1BB: the cost of the bungalow at Grand Paradi was Rs. 5 lacs in 1976 whereas the value computed as per Rule 1BB was worked out at Rs. 62,687 only. Aggrieved by the orders of the CIT (Appeals), the assessee is in appeal before us.

4. Sri S.E. Dastur, the learned counsel for the assessee, submitted that it was a case of simple transfer on 7-10-1986 and not a transfer under Section 45(4) of the Act. Therefore, in view of the decision of the Supreme Court in the case of K.P. Varghese v. ITO [1981] 131 ITR 597, unless there was an evidence of underhand transaction or receipt of money over and above the agreed price, no capital gains could be charged to tax. The letter dated 27-10-1986 and the share certificates were the evidence relied upon inviting our attention to Section 34 of Evidence Act. Section 45(4) of the Act, according to him, applies only in two situations: (0 on dissolution and (ii) on retirement. On 7-10-1986, he submitted, neither was there a dissolution nor a retirement. The decision of the Supreme Court in the case of McDowell & Co. Ltd. (supra), he submitted, did not apply to turn a legal way possible if the other way was more beneficial to the revenue. On 7-10-1986, Section 45(4) of the Act was not there at all as it was proposed to be introduced by the Finance Bill, 1987, presented in Parliament on 28-2-1987 and, therefore, no motive could be attributed to avoid its applicability. Reliance in this connection was placed on the decision of the Supreme Court in the case of CIT v. Provident Investment Co. Ltd. [1957] 32 ITR 190.

5. Even if Section 45(4) of the Act applies, the learned counsel submitted, there being no transfer or deemed transfer, the distribution of assets or even extinguishment of a right on dissolution or retirement, if any, would not be liable to capital gains tax. In this connection, he relied on the decision of the Supreme Court in the case of Malabar Fisheries Co. v. CIT [1979] 120 ITR 49 wherein it was held that on dissolution of firm, there is no transfer of assets to the partners and another decision of the Supreme Court in the case of Addl.

CIT v. Mohanbhai Pamabhai [1987] 165 ITR 166 upholding the decision of the Gujarat High Court wherein it was held that on retirement, there is no transfer of assets by the firm to the partners. He further submitted that it could be a realisation of existing rights of the assessee and, that also, in view of the decision of the Supreme Court in the case of Sunil Siddharthbhai v. CIT [1985] 156 ITR 509, was not liable to tax.

He further submitted that the definition of the term "transfer" given in Section 2(47) of the Act, does not include the "distribution of assets on dissolution or retirement" in its ambit as it includes the "transfer by way of conversion of capital asset into stock-in-trade" brought similarly to tax under Section 45(2) of the Act. Referring to the Budget proposals for introducing Section 45(4) of the Act, reported in 152 ITR 29 at 34 St.., he submitted that the intention might be clear for inserting the provisions to tax the difference between the market value and the cost of the property, but, if the language is not made clear, no effect thereof could be given to such a misfired provision. In this connection, he relied upon the decision of the Bombay High Court in Elphinstone Spg. & Wvg. Mills Co. Ltd. v. CIT [1955] 28 ITR 811, approved by the Supreme Court in CIT v. Elphinstone Spg. &Wvg. Mills Co. Ltd. [1960] 40 ITR 142, the decision of the Supreme Court in the case of CIT v. Khatau Makanji Spg. & Wvg. Co. Ltd. [1960] 40 ITR 189; the decision of the Supreme Court in CIT v. Ajax Products Ltd. [1965] 55 ITR 741 and in the case of CIT v. Amarchand N.Shroff [1963] 48 ITR 59; the Calcutta High Court decision in the case of CIT v. Justice R.M. Datta [1989] 180 ITR 86; and the decision of the Bombay High Court in the case of CIT v. Smt. T.P. Sidhwa [1982] 133 ITR 6. The learned counsel for the assessee further submitted that the scheme of assessing such gains be seen as a whole. On deeming the difference between the market price as sale consideration for the purposes of Section 45(4) of the Act, the provision deeming cost of acquisition in the hands of the partners by the provisions contained in Section 49(1)(iii)(b) are deleted with regard to distribution on dissolution of firm effected before 1-4-1987. In support of his stand, the learned counsel relies on the decision of the Supreme Court in the case of K.P. Varghese (supra).

7. Inviting our attention to the provisions of Section 3 of the Act, the learned counsel further submitted that in any case, the transfer did not fall in the previous year relevant to the assessment year 1988-89. The assessee had opted a previous year ending 30th June for the business income. No choice of the "previous year" is given for the assessment of capital gains and, therefore, it has to be the financial year and for this proposition, he relied on the decisions of the Bombay High Court in the case of CSTv. Brihan Maharashtra Sugar Syndicate Ltd. [1987] 165 ITR 217 and CIT v. Vishnudayal Dwarkadas [1980] 123 ITR 140.

For each transaction of capital asset, the assessee had a right to adopt a previous year and to substantiate this, the learned counsel invited our attention to the provisions of Section 70 of the Act for set off of loss of one source against the income of another source and the decision of the Madhya Pradesh High Court in CIT v. Lady Kanchanbai [1962] 44 ITR 242 as approved by the Supreme Court in CIT v. Lady Kanchanbai [1970] 77 ITR 123 and the Commentary of Chaturvedi & Pithisaria, Vol. I, page 204 besides the decision of the Allahabad High Court in the case of Seth Shiv Prasad v. CIT [1972] 84 ITR 15 for the proposition that each dividend receipt is a separate source.

8. On the aspect of valuation, the learned counsel submitted that the partners were tenants and therefore, the market value has to be worked out on rent capitalisation method. Working on this basis, he pointed out to us that the value of the property at Beach Candy apartments would be Rs. 1,21,500, as worked out by the valuer at page 146 of the paper book and Rs. 2,10,600 for Grand Paradi property, as worked out at page 153 of the paper book. The adoption of land and building method for arriving at the market value, he submitted, is not justified. He also invited our attention to two decisions of the Jurisdictional High Court, namely, Madhusudan Dwarkadas Vorav. Superintendent of Stamps [1983] 141 802, a case under Probate Duty Act and Jehangir Mahomedali Chagla v. M.V. Subrahmanian, Addl. First ACED [1985] 155 ITR 637 (Bom.), a case under the Estate Duty Act, where the provisions of Rule 1BB of the Wealth-tax Rules were held applicable for arriving at the market value for the levy of Probate Duty and Estate Duty.

9. The learned Departmental Representative, Sri Keshav Prasad, on the other hand, submitted that Section 45(4) of the Act is clearly applicable in the instant case. Section 45(4) of the Act, according to him, covers not only the transfers "by way of distribution of assets on dissolution of firm" but transfers "otherwise" as well. Withdrawal of assets, by whatever name called, from the firm, was a transfer even under Section 2(47)(vi). The firm has allowed the possession of the assets to the partners as is evident from page 168 of paper book, which is a letter by the firm addressed to the Society, to change the name of ownership. He further submitted that Section 45(4) of the Act is a specific mode of transfer and the words "or otherwise" includes every such distribution not necessarily on dissolution or retirement alone.

Section 49(1)(iii)(b) of the Act is only for determining the cost of acquisition of the partners and for no other purpose. It does not play any role for interpreting the provisions of Section 45 (4) of the Act.

The words "or otherwise" are not there in that section and, therefore, it has nothing to do with the interpretation of Section 45(4), which in this case, was clearly applicable. As regards the previous year, he relied upon the order of the CIT (Appeals) and submitted that the Bombay High Court decisions relied upon by the learned counsel were concerning the Indian Income-tax Act, 1922 and, therefore, have no application to the provisions of Section 3 of the Income-tax Act, 1961.

On valuation, he supported the orders of the departmental authorities and submitted that if the assets are valued on the basis of Rule 1BB of the Wealth-tax Rules, it gives a value magnificiently lower than the written down value at which they were transferred by the assessee and in that case, the assessee should have filed the gift-tax return and paid tax on the difference between the written down value and the value arrived at under Rule 1BB of the WT Rules. Having not so done, he submitted, the assessee admitted the non-applicability of this provision.

10. The learned counsel for the assessee, in reply, submitted that there is a distinction between the dissolution of the firm and dissolution of partnership. In this connection, he referred to the decision of the Bombay High Court in the case of CIT v. Tribhuvandas G.Patel [1978] 115 ITR 95 and in the case of CIT v. H.R.

Aslot [1978] 115 ITR 255. The firm is continuing and, therefore, there was no dissolution of the firm even though it might be a dissolution of partnership on retirement of one of the partners. On dissolution, he reiterated that there was no transfer. Even if it was a transfer under Section 2(47)(vi) of the Act, it was not on dissolution or by way of distribution of assets, "or otherwise". Withdrawal was not a distribution as it had to be on the profit sharing ratio. It was a case of simple transfer on 7-10-1986 at the written down value giving rise to no capital gains. The fact that the case laws on previous year were rendered under the 1922 Act, he submitted, does not make any difference as under both the Acts, the previous year is financial year unless opted otherwise.

11. We have heard the parties and considered their rival submissions.

On perusal of the books of accounts produced and copies of accounts of the partners and the immovable properties, we find that the two impugned properties were taken out of the firm's coffers by entries made on 7-10-1986. The two properties were in the respective names of the partners who have taken over them. It is a settled law that the firm is not a legal entity. It is a compendious name of the partners and," therefore, whenever a property is brought in or taken out, no formal document, much less a registered document, is necessary. The entries in the books and the surrounding circumstances are sufficient to complete the sale and purchase inter-se between the firm and the partners. The entries in the books of the firm appear thus :Oct. 86 7 JV-7/86-87 The accounts of the two partners who have withdrawn the properties are as under:Date Particulars Refer- Debit Credit Ence01-07-86 Balance b/f.

- - 1,62,884.9307-10-86 To Beach26-10-86 To Bank P-434 4,900.0007-10-86 To rent13-11-86 To Bank P-596 16,400.0002-12-86 To Bank P-647 2,400.0012-02-87 To Bank P-1042 400.0008-04-87 To Bank P-1455 9,778.0019-05-87 To Bank P-1719 35,000.0001-06-87 To Bank P-1829 1,200.0030-06-87 To Apt.

& Loss A/c.

JV-490 - 6,49,940.82 ----------01-07-87 By balance ---------- ---------- b/fd.

5,75,986.25 ----------Date Particulars Refer- Debit Credit Ence01-07-86 Bal. b./f.

- 1,90,866.48 -18-07-86 By Bank DP-11 - 6,000.0029-08-86 By Bank DP-24 - 3,600.0007-10-86 To Grand Paradi Apts.

JV-7 3,90,230.78 -07-10-86 To Rent July to Sept 86 @ 1950 JV-8 5,850.00 -17-11-86 By Bank DP-96 - 8,000.0019-11-86 By Bank DP-98 - 9,000.0001-04-87 By Bank DP-229 8,000.0003-04-87 By Bank DP-235 - 7,200.0021-05-87 To Bank BD-744 3.06,000.00 -30-06-87 To w.d.v. of car transferred.

JV-135 3,934.40 -30-06-87 To w.d.v. of account.

JV-490 - 4,05,753.5930-06-87 By N.R. Kapur Capital A/c.

JV-491 - 2,00,000.00 ----------30-06-87 By Bal. carried - 2,73,063.07 down Besides the above, we find a letter dated 27-10-1986 written by Grand Paradi Co-operative Housing Society Ltd. to the following effect (p.

168 of paper book): With reference to your letter dated 7-10-1986 requesting deletion of Burlington's Export name from the Share Certificate No. 162, we confirm having done the same and issued the Share Certificate to Mr.

N.R. Kapur.

The share certificate No. 162, a copy of which appears on page 169 of the compilation, was originally in the name of "Shri Naveen Roy Kapur of M/s. Burlingtons' Exports" issued on 30-6-1979. Thereafter, it stands in the name of "Shri Naveen Roy Kapur" and the words "of M/s.

Burlingtons' Exports" were deleted. The share certificate No. 51 of New Beach Candy Co-operative Housing Society Limited is dated 14-11-1968.

It was in the name of "Mr. R.K.A. Kapur". From the current account of Sri R.K.A. Kapur, extracted above, we find that he was charged for the payment of rent for July to September, 1986 @ Rs. 900 per month on 7-10-1986 (Rs. 2,700). His account was debited on 30-6-1987 by a sum of Rs. 27,194.50 for maintenance charges paid by the firm. Similarly, Sri N.R. Kapur was charged rent for the

months of July to September, 1986 @ Rs. 1950 per month and his account was debited by a sum of Rs. 5,850.

These circumstances, in our opinion, clearly show that the transaction of transfer of the impugned two properties was complete on 7-10-1986 by which the two properties ceased to belong to the assessee-firm and became the properties of the individual partners. The allegation of the departmental authorities that there was no evidence for the transfer of the properties on 7-10-1986 has, thus, no force. In our opinion, from the facts stated above, it is clear beyond doubt that the properties were taken out by the two partners on 7-10-1986 and on that day, there was a valid transfer thereof to the partners.

12. The Assessing Officer has further alleged that the introduction of the wife of Sri R.K.A. Kapur by the deed dated 7-3-1988 was a colourable device, if one looks at the sequence of events, i.e., the transfer entries for the properties on 7-10-1986; the introduction of Mrs. Sunita on 7-3-1988; the retirement of N.R. Kapur coupled with the fact of culminated firm of husband and wife whose income is liable to be clubbed under Section 64 of the Act in one hand; the requirement of notice of three months to be given by the partner intending to retire.

These, according to him, in the light of the decision of the Supreme Court in the case of McDowell & Co. Ltd. (supra) suggest a clear case of dissolution and the transaction was to avoid the applicability of the provisions of Section 45(4) of the Act. Suffice it would be to say that when the impugned properties were taken out of the firm's chest, there was not even a whisper or proposal of introducing the provisions of Section 45(4) of the Act. It came on the surface, for the first time, on 28-2-1987 with the introduction of the 1987 budget. In these circumstances, to attribute motives to the assessee to avoid the provisions of the law, or to evade tax is far from reality and too remote a conclusion. We may quote the following observations of the Supreme Court in the case of Provident Fund Investment Co. Ltd. (supra) in this connection: It is worthy of note that 'capital gains' were charged for the first time by the Income-tax and Excess Profits Tax (Amendment) Act, 1947, which Inserted Section 12B in the Act. It taxed 'capital gains' arising after the 31st March, 1946 and the levy was virtually abolished by the Indian Finance Act,

1949, which confined the operation of the section to'capital gains' arising before the lstApril, 1948. The Finance (No. 3) Act, 1956(77 of 1956) re-introduced the section in wider terms so as to bring within 'capital gains' 'any profits or gains arising from the sale, exchange, relinquishment or transfer of a capital asset effected after 31-3-1956 etc.' We are not, however, concerned with the question whether the transaction under our consideration, which took place in 1946, resulted in capital gains within the meaning of Section 12B as it stands after the enactment of the Finance (No. 3) Act, 1956 (77 of 1956). The question before us is whether the transaction under consideration resulted in capital gains within the meaning of Section 12B as it originally stood.

Two other points must be stated at the outset in order to clear the ground for a consideration of the relevant arguments advanced before us. The first point is that there is no question here of the assessee-company trying to circumvent the provisions of Section 12B of the Act by deliberately modifying the original agreement (by its letter dated 7th October, 1946) so as to put the transaction outside the scope of that section. The agreement was modified in October, 1946, before even the insertion of Section 12B in the Act.

Therefore, no question of deliberate or fraudulent evasion arises in this case.

Even otherwise, no attempt has been made by the revenue to challenge the existence of the entries in the assessee's books or doubted the existence of other material on record, suggesting the transfer on 7-10-1986. The CIT(A) has not considered the share certificate and the change in the share certificate by letter dated 27-10-1986 by the society, on the ground that they were not produced by the assessee before the Assessing Officer, even though they existed. These documents are only supporting evidence to the entries made by the assessee in the books on 7-10-1986 which are relevant for inquiry by the court, as provided in Section 34 of the Evidence Act, reproduced below: 34. Entries in books of account, regularly kept in the course of business, are relevant whenever they refer to a matter into which the Court has to inquire, but such statements shall not alone be sufficient evidence to charge any person with liability.

13. We are conscious of the limitations with which the provisions of Evidence Act could be imported into tax litigation but looking to the facts and circumstances of the case, we could not refrain ourselves to make a reference thereof, particularly in view ofthe fact that there is nothing on the record to doubt the entries regarding these two properties in the books regularly maintained by the assessee.

14. The question, therefore, is whether the provisions of Section 45(4) of the Act are applicable to the transaction in question. This section was introduced by the Finance Act, 1987, with effect from 1st April, 1988. Its object, as we find in the Memorandum of Explanation is to bring to tax the difference between the market value and the cost of acquisition of a capital asset taken out by a partner out of the coffers of the firm. The Memorandum explaining the provisions in the Finance Bill, 1987, states in paragraph 36 as under: 36. As per the existing provisions of Section 45 of the Income-tax Act, profits or gains arising from the transfer of a capital asset are chargeable to income-tax as capital gains in the year in which the transfer takes place. With a view to preventing misuse of entities such as partnership firms, etc., as escape routes for avoiding capital gains tax, the Bill by inserting a new Sub-section (3) in Section 45 seeks to provide for charging to tax of the profits or gains arising from the transfer of a capital asset by a partner to a firm or by a member to an association of persons or body of individuals, or vice versa. In view of the practical difficulties in evaluating the consideration for transfer in such cases, the Bill seeks to provide certain deeming provisions as well.

Thus, in a case of transfer of a capital asset by a partner to a firm, or by a member to an association of persons, or body of individuals, the amount recorded in the books of account of the firm, association or body as the value of the capital asset, shall be deemed to be the full value of the consideration as a result of such transfer by way of distribution of capital asset by a firm, an association of persons or a body of individuals, the fair market value of the asset as on the date of transfer shall be deemed to be the full value of the consideration as a result of such transfer consequential amendments to Sections 47 and 49 have also been proposed.

The Central Board of Direct Taxes has issued a circular regarding the scope of the newly added provision and in paragrpahs 24.3 and 24.4 of the said circular bearing No. 495 dated 22nd September, 1987 (168 ITR St. 100-101), it is stated as under: 24.3 Conversion of partnership assets into individual assets on dissolution or otherwise also forms part of the same scheme of tax avoidance. Accordingly, the Finance Act, 1987 has inserted new Sub-section (4) in Section 45 of the Income-tax Act, 1961. The effect is that profits or gains arising from the transfer of a capital asset by a firm to a partner on dissolution or otherwise shall be chargeable as the firm's income in the previous year in which the transfer took place and for the purposes of computation of capital gains the fair market value of the asset on the date of transfer shall be deemed to be the full value of the consideration received or accrued as a result of the transfer.

24.4 As a consequential measure, Clause (ii) of Section 47, has been omitted and Sub-clause (b) of Clause (iii) of Section 49(1) has been amended.

(4) The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or a 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.

The definition of the term "transfer" has been extended by inserting Clause (iv) in Section 2(47) of the Act so as to include any transfer which has the effect of transferring or enabling enjoyment of any immovable property. It reads as under: (vi) any transaction (whether by way of becoming a member of or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

15. Section 47(ii) hitherto exempting distribution of capital assets on the dissolution of the firm, association of persons, body of individuals, by not treating

the distribution as transfer has been deleted consequent upon the amendments being made to Section 45 of the Act, as aforesaid. Similarly, Section 49(1)(iii)(b) was amended with regard to the deemed cost of acquisition under the existing provisions where the capital asset becomes the property of the firm on any distribution of assets on the dissolution of a firm, body of individuals or association of persons. The cost of acquisition of assets is deemed to be the cost for which the previous owner of the property acquired it, subject to certain adjustments regarding improvements, etc. Upon the amendments, the provisions will apply only if the dissolution takes place any time before 1st April, 1987.

16. With this background, let us see the applicability of Section 45(4) to the facts of the instant case. As we have already held, the two properties were taken by the partners out of the coffers of the firm on 7-10-1986 and, therefore, the transfer has taken place on that date. It is not the case of the department that there was a dissolution on 7-10-1986. Therefore, there was no transfer on the dissolution of the firm, so as to attract the applicability of the provisions of Section 45(4) of the Act. In these circumstances, it is not necessary for us to deal with the larger question raised by the learned counsel for the assessee, Sri Dastur, that under the general law, there is no transfer of asset by the firm to the partners on dissolution of a firm and, therefore, the provisions of Section 45(4) are redundant and/or misfired.

17. The contention of the learned Departmental Representative, Sri KeshavPrasad, however, is that there was a transfer on 7-10-1986 under Clause (vi) introduced in Section 2(47) of the Act, by the Finance Act, 1987. Under this clause, he submitted, any transaction (whether by way of becoming a member of or acquiring shares in a co-operative society, company, or other association of persons or by way of any agreement or any arrangement, or in any other manner whatsoever), which has the effect of transferring or enabling the enjoyment of, any immovable property, is deemed as a transfer. In his contention, therefore, the firm having transferred the properties enabling the enjoyment thereof by the partners under this clause, the transaction would be covered by the words "or otherwise" used in Section 45(4) of the Act. The fact that there was a transfer of these properties on 7-10-1986 is also not disputed by the learned counsel for the

assessee. His contention, however, is that the words "or otherwise" used in Section 45(4) of the Act, do not embrace such transactions as these words are followed by the preceding words "dissolution of firm, association of persons, or body of individuals" and, therefore, the words "or otherwise" have to have similar meanings of the nature of dissolution. Such a situation which he could anticipate is only in a case of retirement. The transfer on 7-10-1986 not being a transfer on retirement as well, he submitted, Section 45(4) has no application. We do not think that such a restricted meaning could be given to the words "or otherwise". A similar type of wordings were used in Section 10 (10A) of the Act, excluding from the total income of an assessee, the payment received from an employer as cash equivalent to leave salary, "on his retirement on superannuation or otherwise". The words "or otherwise" were susceptible of an unrestricted meaning to include the cash equivalent to leave salary even when the employee was in the service and, therefore, the phraseology was later modified to "on his retirement whether on superannuation or otherwise" to have the restricted meaning of nature or the colour of retirement on superannuation.

18. We, however, find force In the contention of the learned counsel for the assessee, Sri Dastur, that In that case also, there should be a distribution of assets by the firm to the partners so as to invoke the provisions of Section 45(4) of the Act. The words "or otherwise" are used as an alternate to the words "on dissolution" and, therefore, in both the situations, Le. on dissolution or otherwise, the distribution of a capital asset is a must. What is distribution of capital asset is not defined in the Act. Generally, it is the allocation of the assets by the firm given to the partners or the legal heirs on dissolution, retirement, death or exclusion of one or more of the partners of the firm and in cases of mere change in the constitution of a firm. Any withdrawal of the capital asset by the partners of the firm from the firm to the exclusion of others might also be a distribution of capital assets. However, if such withdrawal is for consideration, it would be a case of sale by the firm to the partners and not distribution. In distribution, no consideration is involved and the partners have to share the withdrawal in their prescribed sharing ratio, agreed to in the partnership deed. We agree with the learned counsel for the assessee that the withdrawal of these properties on 7-10-1986 by the two occupant-partners was not a distribution of capital asset. It was not without any

consideration. Partners' accounts were debited by the respective consideration agreed, Le. the written down value of the two properties. The profit sharing ratio of Sri R.K.A. Kapur and Sri N.R.Kapur, as on the date of withdrawal, Le. on 7-10-1986, was 51 per cent and 49 per cent respectively. The written down values of the properties taken out by them were Rs. 1,36,867 and Rs. 3,90,230 and the market values as stated by the Assessing Officer Rs. 69,07,500 and Rs. 84,00,000 respectively. Neither of these two sets of figures of written down values or market values are in profit sharing ratio. No evidence has been brought on record to suggest that the difference arising because of the withdrawal, otherwise than in profit sharing ratio was settled by the two partners in any other way. The contention of the learned Departmental Representative, Sri Keshav Prasad, that the words "or otherwise" is an alternate to or disjunctive of "on dissolution" and, consequently, the transfer of capital assets otherwise than by way of distribution on dissolution can also be covered by Section 45(4) of the Act, in our opinion, cannot be accepted. If that were the case, all transactions, whether by or between the firm, association of persons or body of individuals, would be covered by the provisions of Section 45(4) of the Act, including those which are normally entered between outsiders and covered by the other provisions of Section 45, such as Sub-sections (1), (2), (3) and (5). A situation would emerge out in that case that the two provisions would exist simultaneously at particular time, side by side. Such an interpretation giving rise to an overlapping of one provision over the other has to be avoided. Even if such an overlapping is permitted or possible, the law favourable to the assessee should prevail. In this case, as we have held, there was a transfer on 7-10-1986 and, therefore, it would fall under Section 45(1) of the Act, which brings to tax only that capital gains which arises to the assessee on transfer. The written down value of the two properties was the consideration that has arisen to the assessee. Amount which is over and above the stated or agreed consideration cannot be brought to tax even though the market value of the two properties was much higher to the stated or agreed consideration. It is not the case of the learned Departmental Representative that the assessee had received the market value of these properties and, therefore, as held by Their Lordships of the Supreme Court in the case of K.P. Varghese (supra), nothing more than what has been agreed to and actually received or recorded, could be brought to tax as

capital gains. The difference, if any, could at best be a deemed gift which is excluded from the ambit of capital gains tax by the provisions of Section 47(ii) of the Act. In our opinion, therefore, Section 45(4) of the Act has no application to the facts of the case before us.

19. There is yet another reason which excludes the transaction in question out of the provisions of Section 45(4) of the Act. The assessee had not declared any capital gain on this transaction. It had also no income under the head "capital gains" and, therefore, the question of declaring income under this head in the return did not arise. It is the department that makes out a case that the assessee had earned income under the head "capital gains". The income of a person is chargeable to tax in an assessment year which he has earned or received in the previous year relevant to that assessment year. The assessment year involved in this case is 1988-89. The term "previous year" is defined in Section 3 of the Act, to mean: 3. 'Previous year' defined: (1) For the purposes of this Act, 'previous year' means- (b) if the accounts of the assessee have been made up to a date within the said financial year, then, at the option of the assessee.

the twelve months ending on such date; or (c) in the case of any person or business or class of persons or business not falling within Clause (a) or Clause (b), such period as may be determined by the Board or by any authority authorised by the Board in this behalf; or (d) in the case of a business or profession newly set up In the said financial year, the period beginning with the date of the setting up of the business or profession and- (ii) if the accounts of the assessee have been made up to date within the said financial year, then at the option of the assessee, ending on that date, or (iii) ending with the period, if any, determined under Clause (c), as the case may be; or (e) in the case of a business or profession newly set up in the twelve months immediately preceding the said financial year- (i) if the accounts of the assessee have been made up to a date within the said financial year and the period from the date of the setting up of the business or profession to such date does not exceed twelve months, then, at the option of the assessee, such period, or (ii) If any period has been determined under Clause (c), then the period beginning with the date of the setting up of the business or profession and ending with that period, (f) where the assessee fs a partner in a firm and the firm

has been assessed as such, then, in respect of the assessee's share in the income of the firm, the period determined as the previous year for the assessment of the income of the firm; or (g) in respect of profits and gains from life insurance business, the year immediately preceding the assessment year for which annual accounts are required to be prepared under the Insurance Act, 1938 (4 of 1938), or under that Act, read with Section 43 of the Life Insurance Corporation Act, 1956 (31 of 1956).

On a bare reading of these provisions, one could say that the previous year is generally the financial year preceding the assessment year. In exceptional circumstances, the previous year can be a period of twelve months ending on any day within such financial year. These exceptions are: (i) if the assessee's accounts are made up to that day and the assessee opts that period as his previous year; (ii) as a period prescribed by the CBDT in cases other than those assessees who adopt financial year or the year on the basis of the closing of the accounts; (iii) the period from business set up to close of accounts in the financial year in cases of assessees setting up new business in financial year and twelve months ending in the financial year if the business was set up prior to the financial year and (iv) the previous year as adopted by the firm for income from partnership, etc. etc. An assessee may have different previous year in respect of different sources of income, as provided in Section 3(3) of the Act. Once an option is exercised fora source of income or he has once been assessed for that source, he is precluded by Section 3(4) to vary the meaning of the previous year, except with the prior approval of the Assessing Officer and with such conditions as he might impose. The provisions of Section 3(3) postulate the possibility of the assessee having different previous years. In fact, this section entitles an assessee to have a different previous year for each source of income. Courts have held that an assessee can adopt different previous years for different sources of income, vide Girdharlal Ghelabhai v. CIT[1964] 53 ITR 23 (Guj.); Sobhag Mal Lodha v. CIT [1967] 63 ITR 424 (All.), J.K.Synthetics Ltd. v. O.S. Bajpai, ITO [1976] 105 ITR 864 (All.) and Addl.

CIT v. K. Ramachandra Rao [1981] 127 ITR 414 (AP). Even a branch can have a separate previous year, as held by the Madhya Pradesh High Court in the case of

Lady Kanchanbai (supra). Similarly, the Allahabad High Court in the case of Seth Shiv Prasad v. CIT [1972] 84 ITR 15, held that each receipt of dividend is a separate source and an assessee can opt different previous years for different receipts of dividend from different companies. Similarly, in our opinion, each transfer of capital asset could be held a different source and the assessee can have a separate previous year for each such transaction. In this case, the only source is the transfer of these two properties during the previous year relevant for the assessment year under consideration and, therefore, the assessee can have a different previous year for this head/source, if it so adopts.

20. The income from capital gains in the year under consideration is not only a different source but is a different head than the business income for which the assessee has adopted 30th June as its previous year. This is, however, subject to the option of the assessee. Once the assessee has opted for a particular previous year for a particular source or it has been assessed for that source by the Assessing Officer, the assessee cannot vary the same. If the assessee has not given his option, then the previous year has to have the general meaning, i.e. the financial year immediately preceding the assessment year, as held by the two decisions of the Bombay High Court in the case of Brihan Maharashtra Sugar Syndicate Ltd. (supra) and in the case of Vishnudayal Dwarkadas (supra). We do not see any merit in the argument of the learned Departmental Representative, Sri Keshav Prasad that the said decisions were rendered under 1922 Act and, therefore, have no application under the Income-tax Act, 1961. The basic provisions under both the enactments for determining the previous year are pari materia.

It is the financial year immediately preceding the assessment year under both the enactments which has to be taken as the previous year for the purposes of assessment under the Income-tax Act. That being so, the transfer having taken place on 7-10-1986 falls in the financial year 1-4-1-986 to 31-3-1987, for which the assessment year would be 1987-88 and not the impugned assessment year 1988-89. The observations of the CIT(A) that the assessee having not declared this source should be presumed to have adopted the previous year followed for the business income has no legal sanctity and cannot be allowed to prevail. It is the

financial year unless opted otherwise by the assessee, which in this case the assessee has not so opted. In assessment year 1987-88, the provisions of Section 45(4) of the Act were not in existence and, therefore, on that ground also, the assessment of capital gains in the assessment year 1988-89 of these properties cannot be upheld.21. The assessee's contention that Section 45(4) is not applicable if read along with Section 49(1)(b)(iii) of the Act and his further contentions on valuations etc. need not now be discussed at this stage and we do not express any opinion thereon, as, in our opinion, even otherwise no capital gain has arisen to the assessee which could be brought to tax under Section 45(4) of the Act.

22. Another dispute in the appeal for 1988-89 assessment year is with regard to deduction under Section 32AB of the Act. The assessee is, as stated above, a firm. The Assessing Officer allowed a deduction of Rs. 3,30,890 under this section while computing the income of the assessee.

He, however, added back the amount so allowed while allocating the income of the assessee-firm to the partners and thereby allocated to the partners the gross amount, without deduction under Section 32AB.There is no discussion in the order of the Assessing Officer as to why he has done so. According to the CIT(A), first proviso to Section 32AB Clearly provided that where an assessee was a Son, deduction under Section 32AB of the Act would not be allowed in the computation of income of any partner. He, therefore, upheld the action of the Assessing Officer in adding back the deduction allowed under Section 32AB of the Act, while allocating the income amongst the partners.

23. The learned counsel for the assessee, Sri Dastur, submitted that what the first proviso prohibits is the allowance of deduction under Section 32AB to the partners again had it been allowed to the firm; that it does not provide the withdrawal of the deduction while allocating the income of the firm to the partners; that the allocation of the firm's income to the partners is provided under Section 67 of the Act and not under Section 32AB of the Act; and that the first proviso to Section 32AB comes into play only when the partners claim the deduction independently by bringing his plant and machinery. He, therefore, objected to add back of Section 32AB

deduction while allocating the income of the firm to the partners. The learned Departmental Representative, Sri Keshav Prasad, on the other hand, supporting the order of the CIT(A), submitted that the proviso to Section 32AB, clearly prohibits deduction to a partner and in case it is not added back to the income of the firm, while allocating the firm's income to the partners, it would amount to an allowance of deduction to the partners as what, according to him, would be allocated, was the gross income and allowance of Section 32AB deduction. Section 67(2) of the Act, in this connection, was relied upon by him, wherein it is provided that allocation of the firm's income is to be computed under the same heads in the hands of the partners in which it was computed in firm's assessment.

24. We have heard the parties and considered their rival submissions.

Section 32AB of the Act provides a deduction called "Investment Deposit Allowance" to an assessee, including a firm, on fulfilment of certain conditions. Those conditions are satisfied in the instant case and the firm is accordingly held by the Assessing Officer himself to be entitled for the same. First proviso to Section 32AB, which is the core of discussion in this case, provides that the deduction under Section 32AB shall not be allowed in the computation of income of any partner, if the assessee who claims the deduction is a firm. It reads as under: Provided that where such assessee is a firm, or any association of persons or any body of individuals, the deduction under this section shall not be allowed in the computation of the income of any partner, or as the case maybe, any member of such firm, association of persons or body ofindividuals.

The prohibition is only for the allowance in computing the income of a partner or member if the claimant of the deduction happened to be a firm, or Association of Persons or Body ofindividuals. We are concerned here with a firm and its partners. How the income of a partner is computed is governed by the provisions which provide the computation of the firm's income. Section 67, however, provides that the income of a firm is to be allocated to the partners in a particular manner. It provides as under: 67(1). In computing the total income of an assessee who is a partner of a firm, whether the net result of the computation of total income of the firm is a profit or a loss, his share (whether a net profit or a net loss) shall be

computed as follows: (a) any interest, salary, commission or other remuneration paid to any partner in respect of the previous year and where the firm is a registered firm or an unregistered firm assessed as a registered firm under Clause (b) of Section 183, the income-tax, if any, payable by it in respect of the total income of the previous year, shall be deducted from the total income of the firm and the balance ascertained and apportioned among the partners; (b) where the amount apportioned to the partner under Clause (a) is a profit, any salary, interest, commission or other remuneration paid to the partner by the firm in respect of the previous year shall be added to that amount and the result shall be treated as the partner's share in the income of the firm; (c) where the amount apportioned to the partner under Clause (a) is a loss, any salary, interest, commission or other remuneration paid to the partner by the firm in respect of the previous year shall be adjusted against that amount and the result shall be treated as partner's share in the income of the firm.

(2) The share of a partner in the income or loss of the firm, as computed under Sub-section (1) shall, for the purposes of assessment, be apportioned under the various heads of income in the same manner in which the income or loss of the firm has been determined under each head of income.

(3) Any interest paid by a partner on capital borrowed by him for the purposes of investment in the firm shall, in computing his income chargeable under the head 'profits and gains of business or profession' in respect of his share in the income of the firm, be deducted from the share.

(4) If the share of a partner In the income of a registered firm or an unregistered firm assessed as a registered firm under Clause (b) of Section 183, as computed under this section, is a loss, such loss may be set off, or carried forward and set off, in accordance with the provisions of this Chapter.

Explanation: In this section "paid" has the same meaning as is assigned to it in Clause (2) of Section 43.

This section does not provide for any exclusion of a deduction allowed to the firm under Section 32AB while allocating the firm's income to the share of the partners.

Therefore, the allocation cannot be in a manner otherwise than as provided under Section 67 of the Act. What is to be excluded and/orincluded and how and in what circumstances the share income of the partner is to be assessed is specifically provided in Section 67 of the Act. The share income of a partner as allocated under Section 67 of the Act is the income subject to computation of partner's income under the Income-tax Act. From this income, an assessee can claim expenditure incurred in relation to or for the purposes of earning that income, as held by the Supreme Court in the case of CIT v. Romniklal Kothart [1969] 74 ITR 57. Section 32AB deduction could have also been claimed by the assessee if he brings his own plant and machinery and satisfy all the conditions laid down therein. This is what, in our opinion, is prohibited by the first proviso to Section 32AB(1) of the Act. The deduction having been allowed already to the firm is prohibited to be allowed again to the partners, from their share of profit from the firm. Further, these provisions are part materia to the provisions of Section 80A(3), of the Act, whereunder also no deduction under Chapter VIA, including deduction under Section 80HHC of the Act, is to be made in computing the total income of a partner of a firm, In relation to the share of such partner In the income of the firm; If such deduction is admissible in computing the total income of the firm. No efforts have been made or attempted to withdraw the deduction under Chapter VIA from the firm's income while allocating the same to the partners. In assessee's own case, Section 80HHC deduction has been allowed by the Assessing Officer at Rs. 18,59,649 in the assessment and in spite of the provisions contained in Section 80A(3), no addition thereof was made while allocating the firm's income to the partners. In our opinion, rightly so. In the same way, the first proviso to Section 32AB(1) cannot be applied for making addition to the firm income for allocating the same in the hands of the partners. The allocation of the firm's income in the hands of the partners, cannot, as we have stated above, be in a manner other than what is provided under Section 67 of the Act. We, accordingly, reverse the orders of the departmental authorities on the point and direct the Assessing Officer not to add the deduction allowed under Section 32AB of the Act while making the allocation of the firm's Income in the hands of the partners. This ground is also accordingly allowed.

25 to 32. [These paras are not reproduced here as they involve minor issues.]

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