

Assistant Commissioner of Vs. Singla Rice and Gen. Mills

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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Apr-17-2002

Reported in : (2002)82ITD778(Delhi)

Judge : P Singh, R Syal

Appellant : Assistant Commissioner of

Respondent : Singla Rice and Gen. Mills

Judgement :

1. This appeal by the revenue is directed against the order passed by CIT(A) in relation to assessment year 1990-91.
2. The solitary effective ground projects the grievance of the revenue as under: -
On the facts and in the circumstances of the case Id. CIT(A) has erred in law and facts in deleting the addition of Rs. 10, 09, 500 on account of capital gain under Section 50.
3. Factual matrix of the case: The assessee filed its return disclosing a loss of Rs. 2,41,390. The Assessing Officer made original assessment at Nil income by ignoring the loss declared on the ground that the return was filed beyond the time limit prescribed under Section 139(1).

On appeal the CIT(A) directed the Assessing Officer to determine the loss as per law and complete the fresh assessment. Subsequently the Assessing Officer completed the assessment vide his order dated 30-3-1994 determining the taxable

income at Rs. 7, 68, 110. While doing so he adopted the fair market value of land, building and machinery on the basis of the valuation report of the Valuation Officer and accordingly worked out the net capital gain at Rs. 10, 09, 499 and also allowed therefrom the loss claimed by the assessee. While working out capital gain the Assessing Officer noted that on 15-9-1989 the assessee-firm consisting of two partners, namely, Sh. Patiram and Sh.

Rai Binder, Karta of Rai Binder (HUF) having shares at 10% and 90% respectively was dissolved and the business carried on by it was taken over by Sh. Rai Binder as karta of HUF under the same name. The Assessing Officer opined that in view of the provisions of Section 45(4) read with Section 2(47) there was a transfer and the gain arising therefrom was liable to be taxed under the head "Capital gains".

Aggrieved thereby the assessee came up in appeal. It was pointed out before the first appellate authority that on 15-9-1989 i. e. the date of dissolution of the assessee-firm there was no "transfer" of any capital asset within the meaning of Section 2(47). It was further submitted that actually there was no dissolution of the firm and only Sh. Patiram voluntarily retired from the firm and the assets and liabilities were taken over by Sh. Rai Binder at book value as stated in the balance sheet drawn on 15-9-1989. Reliance was placed on the decision of Apex Court in the case of *Malabar Fisheries Co. v. CIT* [1979] 120 ITR 49 to contend that the property of the partnership firm originally belonged to the partners and after the retirement of Sh.

Patiram the property vested with Sh. Rai Binder and as such no transfer took place between two separate legal entities. The report of the valuation officer was also challenged before the CIT(A) by submitting that the Assessing Officer had failed to appreciate that the provisions of Section 50 which were invoked by him for computing capital gains were inapplicable in respect of value of land. The Id. CIT(A) after considering the submissions advanced on behalf of the assessee overturned the order of the Assessing Officer by holding that there was no transfer of any assets resulting into capital gain.

4. Before us the Id. DR assailed the findings of the CIT(A) by contending that the latter has miserably failed to appreciate the provisions of the Act. It was pointed

out that the assessemnt year under consideration was 1990-91 and the provisions of Section 45(4) which were introduced w. e. f. assessment year 1988-89 were squarely applicable to the facts of the case as a result of which the capital gain was liable to be charged on dissolution of firm. The Id. DR strongly urged that the CIT(A) erred in holding that there was no "transfer" within the meaning of Section 2(47) and hence no capital gain was chargeable. It was pointed out that primarily Section 45(4) was complete in itself which clearly mandates that on the dissolution of the firm transfer shall be deemed to have been taken place and there was no necessity to look into the provisions contained in Section 2(47). Our attention was further drawn towards Section 47(ii) which was omitted w. e. f. assessment year 1988-89, the effect of which according to the Id. DR was that the distribution of capital assets on dissolution of firm amounted to 'transfer' and hence the capital gain was chargeable. It was vehemently argued by the Id. DR that the reliance of the Id. CIT(A) on the case of Malabar Fisheries Co. (supra) was not relevant for the reason that after the insertion of Section 45(4) this decision was no more a good law in this context. It was contended by the Id. DR that when one of the partners retired from a firm consisting of two partners, it was a clear cut case of dissolution of firm and the provisions of Section 45(4) were clearly attracted.

Reliance was placed on the case of Suvardhan v. Asstt. CIT [1998] 67 ITD 104 (Bang.) and Swamy Studio v. ITO [1998] 66 ITD 276 (Mad.) to contend that the facts involved in the present case were identical to those considered by these Benches of Tribunal wherein it was laid down that the provisions of Section 45(4) were attracted. The Id. DR also relied on the decision of Summit Court in AL. A Firm v. CIT [1991] 189 ITR 285' (SC) to point out that on dissolution of firm, stock in trade was liable to be valued at market price. In the final submissions the Id. DR contended that the Id. CIT(A) did not consider the factual and legal position in right perspective as a result of which there was a miscarriage of justice.

5. In the opposition the Id. counsel for the assessee strongly supported the order passed by CIT(A) and his submissions were reiteration of reasoning recorded by latter to delete the addition. It was contended that there was no mistake committed by CIT(A) warranting any interference. It was stated in specific that the firm which originally came into existence on 14-5-1979 underwent a change in constitution on

17-8-1985, as a result of which only two persons, namely, Sh. Patiram and Sh. Rai Binder (HUF) continued to be partners of the firm. Our attention was invited towards page 82 onwards of the paper book on which copy of partnership deed was placed. It was pointed out that on 16-9-1989 a deed of dissolution was executed the effect of which was that Sh. Patiram who Was having ill health voluntarily retired from the partnership business by accepting the amount standing to the credit of his capital in full and final settlement and no valuation of assets was undertaken. Copy of dissolution added was placed at pages 80-81 of the paper book. The contention of the Id.counsel was that it was not a dissolution of the firm but the case was that one of the partners retired and the business as such was continued by the other partner. It was submitted that the assets of the partnership firm were taken by the continuing partner at the book value/Reliance was placed on the decision of Malabar Fisheries Co. 's case (supra) to contend that a partnership firm is not a distinct legal entity apart from the partners constituting it and equal in law the firm as such has no separate rights of its own in partnership assets.

It was submitted that the continuing partner who was earlier having 90% share in profits in the partnership firm subsequently acquired 100% share in the assets of the firm. A further contention was raised by the Id. counsel that though Section 45(4) was inserted w. e. f. assessment year 1988-89 but no consequential amendment was carried out under Section 2(47) to provide that the distribution of assets on the dissolution of firm would amount to 'transfer'. As the distribution of assets on the dissolution did not constitute 'transfer' under Section 2(47), the Id. counsel pleaded that provisions of Section 45(4) could not be employed for charging 'capital gains'. It was further stated that the primary condition for the applicability of Section 45(4) was that there should be distribution of capital assets on the dissolution of firm. The distribution of capital assets in the opinion of Id.counsel amounted to physically dividing the assets between the partners on dissolution. As there was no such division and moreover there was no dissolution of the firm the Id. counsel pleaded that the case was out of the ambit of Section 45(4). A still further contention was raised that the continuing partner carried on the business as such and there was no discontinuance of business at any point of time. Relying on the decision of Apex Court in the case of Sakthi Trading Co. v.

CIT [2001] 250 ITR 8711 the Id. counsel pleaded that there was no dissolution of firm. A further contention was raised to the effect that the Assessing Officer had computed capital gain under Section 45(4) on the basis of report obtained from valuation officer for which he was not competent.

While taking us through the computation of capital gain as per page 6 of the assessment order, the Id. counsel pleaded that the Assessing Officer had applied provisions of Section 50 for computing capital gain on land, building and machinery. As the land was a non-depreciable asset and did not constitute a block of asset in itself for this purpose, the Id. counsel pleaded that the Assessing Officer erred in resorting to Section 50 for computing capital gain in respect of land.

As regards the valuation of building and machinery, the Id. counsel pleaded that there were many infirmities in the report of the valuation officer which were also brought to the notice of the Assessing Officer but no consideration was given to such infirmities and the Assessing Officer mechanically admitted the same figure for the purposes of full value of consideration as fair market value. The Id. counsel pleaded that the reliance placed by the Id. DR on the decision of A.L.A. Firm's case (supra) was misconceived as the same was overruled by subsequent decision by the Apex Court in Sakthi Trading Co. 's case (supra).

6. A further reliance was placed on the decision of Apex Court in the case of CGT v. T. M. Louiz [2000] 245 ITR 8. 312 to contend that the retirement of partner from the firm did not come in the scope of word 'transfer'. It was submitted that the Hon'ble Apex Court in this case has laid down that since on retirement of partner from the firm there was no transfer of property therefore no gift tax was leviable. A further reliance was placed on the decision of Apex Court in the case of B. T. Patil & Sons v. CGT [2007] 247 ITR 5883 to contend that the distribution of assets did not amount to deemed gift. The Id. counsel also placed reliance on the decision of Delhi Bench of Tribunal in the case of Shahdara Aluminium Factory v. ITO [IT Appeal No. 1184 (Delhi) of 1996] to point out that the assessee could not be assessed under the head capital gain for this transaction. In the alternative it was contended by the Id. counsel that if at all Bench did not agree with his contention as regards the transfer and holds that the provisions of Section 45(4) are

applicable in that case, then the Assessing Officer should be directed to consider the objections as regards infirmities in the valuation report and should be barred from computing, capital gain on land because the same was not the subject matter of Section 50, which-he had wrongly applied earlier. It was also urged that if at all capital gain was to be levied, it should be restricted to only 10% and not 100% because the continuing partner acquired only 10% more as a result of retirement of the outgoing partner.

7. In the rejoinder the Id. DR contended that the decision at A. L. A.Firms' case (supra) was not overruled by the Apex Court in subsequent decision but it was only distinguished on facts. It was also fairly conceded by the Id. DR that certain deficiencies pointed out by the assessee in the valuation report were not attended to by the Assessing Officer before finalising the assessment.

8. We have considered the rival submissions in the light of material placed before us and precedents relied upon. In order to decide the applicability of Section 45(4) it is of paramount importance that the first question should be decided as to whether there was any distribution of capital assets on dissolution of firm. As regards the dissolution of the firm the case of the revenue is that that firm stood dissolved when one partner retired from the firm whereas the assessee is contending that there was no dissolution and the business continued as such. From the facts of the case it is noted that w. e. f. 17-8-1985 only two persons, namely, Sh. Patiram and Sh. Rai Binder (HUF) were left in the firm. As per the dissolution deed dated 16-9-1989 one of the partners, namely, Sh. Patiram stepped out of the firm as a result of which only Sh. Rai Binder (HUF) continued the business under the same name. When there are two partners in a firm and one of them steps out obviously no partnership firm remains into existence. The primary condition for formation or continuation of a partnership firm is that there should be two or more persons to constitute a firm. As in the present case there remained only one person, namely, Sh. Rai Binder, who continued the business we do not understand as to how a contention can be raised that the partnership firm was not dissolved.

9. The second issue is as to whether there was any distribution of capital assets on dissolution of firm. The contention raised by the Id.counsel is that the outgoing partner accepted his capital balance in full and final settlement and no revaluation of assets was done and the remaining partner obtained the assets of the firm at its book value.

When the firm stands dissolved and one of the partners accepts capital assets at book value and the other partner accepts his credit balance in capital account in full and final settlement, it clearly amounts to distribution of capital assets amongst the partners at their book value. We therefore find that in the present case there was dissolution of firm and distribution of capital assets as well.

10. Now we would deal with the contention raised by the Id. counsel that there was no transfer as envisaged under Section 2(47) and as such the provisions of Section 45(4) were not applicable. On perusal of Section 2(47) it comes to light that the definition of- the word 'transfer' has been given in an inclusive manner. If a particular situation has not been contemplated specifically in section but is otherwise understood as transfer in common parlance it clearly stands covered within the definition of terms "transfer". However, it is pertinent to note that sections 45(3) and 45(4) were inserted by the Finance Act, 1987 w. e. f. 1-4-1988. In so far as Section 45(3) is concerned it is noted that Clause (iv) to Section 2(47) was inserted simultaneously w. e. f. the same date to show that it was specifically included in the word 'transfer'. But as far as Section 45(4) is concerned, it is noticed that prior to Finance Act, 1987 there was Clause (ii) of Section 47 which read as under: - In distribution of capital assets on the dissolution of firm, body of individuals or otherwise association of persons.

Since this clause was earlier contained in Section 47 it meant that the distribution of capital assets on dissolution of firm etc. were not regarded as 'transfer'. It is seen that the Finance Act, 1987 w. e. f.

1-4-1988 omitted this clause, the effect of which is that the distribution of capital assets on dissolution of firm would henceforth be regarded as 'transfer'. Therefore instead of incorporating the effect of Section 45(4) in Section 2(47) the suitable amendment was carried out by the same Finance Act in Section 47 the result of

which is that the distribution of capital assets on the dissolution of firm would be regarded as 'transfer'. Therefore the contention that since Section 2(47) did not contemplate the transfer as noted in Section 45(4) and hence no capital gain is chargeable, is bereft of any force.

We therefore hold that the capital gain was liable to be charged on dissolution of firm on 16-9-1989.

11. The Id. counsel has also raised a very interesting proposition by tendering that Sh. Rai Binder (HUF) was earlier having 90% share in the profit ratio which was subsequently converted into 100% share and therefore he became the additional owner only for 10% which was the share of retiring partner in the firm and hence at the most only 10% of the total capital gain could be charged. He also placed reliance on the decision of Malabar Fisheries Co. 's case (supra) to contend that the firm was not a distinct legal entity apart from partners. There is no dispute about the proposition as laid down by the Hon'ble Apex Court that the partnership firm is not a distinct legal entity apart from the partners constituting it. At the same time it is relevant to note that partnership firm is a separate taxable entity distinct from its partners so far as the provisions of Income-tax Act, 1961 are concerned. Section 2(31) states that 'person' includes individual, HUF, company firm, etc. It is therefore apparent that the firm has been separately considered to be a 'person' for the purposes of Income-tax Act distinct from its partners who are "individuals" in their separate capacities. As regards the argument that the continuing partner obtained only 10% additional share and the capital gain only to the extent of 10% of the assets is exigible, we find no force in this contention. The provisions of Section 45(4) clearly stipulate and impose the liability arising under the head 'Capital gain' on the distribution of capital assets on dissolution of firm. The liability has been fastened on the firm and not on partners. So far as the firm is concerned there is complete distribution of its capital assets and therefore to contend that capital gain should be charged only in respect of 10% of the assets is devoid of merits. The liability for capital gains falls on the firm on distribution of its capital assets.

In the present case the firm got dissolved and all its assets were distributed. We therefore hold that capital gain is exigible in respect of all the capital assets as considered by the Assessing Officer.

12. Another plea was also raised by the Id. counsel to contend that the decision of Apex Court in Sakthi Trading Co. 's case (supra) has reversed the decision of A. L. A. Firm's case (supra) and as such on dissolution of firm the assets were to be valued at cost or market price whichever is lower. We are not agreeable with this contention for the sole reason that this decision was primarily laid down in respect of assessment year 1984-85 i. e. prior to insertion of Section 45(4).

The other distinguishing feature of this decision is that the observations of the Hon'ble Apex Court were with reference to the valuation of the closing stock and not capital assets. The third distinguishing feature is that in that case the firm consisting of six partners was dissolved on the death of one of the partners and on the immediately next day a new firm was reconstituted. In contrast it is noted that in the instant case there was no reconstitution of the firm and naturally it can't be because after the retirement of one out of two partners, the firm stood dissolved. We are therefore of the considered view that this decision does not advance assessee's case any further. As regards reliance placed by the Id. counsel on the decision of Shahdara Aluminium Factory's case (supra) the same is also distinguishable because in that case also two partners retired from the firm comprising of five partners and the firm was continued by the remaining three partners. In contrast it is noted that the decision of Madras Bench in Swamy Studio's case (supra) relied upon by the Id. DR is clearly applicable to the facts of the present case as in that case also after dissolution of the assessee-firm its business was taken over by one of the partners and the difference between the market value of the properties and its cost was taken as capital gain. To similar effect is the order of Bangalore Bench Suvardhan 's case (supra) where it was held that distribution of capital assets on dissolution of firm amounted to transfer and it was exigible to capital gain tax. If in the present case, the contention of the assessee is accepted that on retirement of one out of two partners there was no dissolution of firm and provisions of Section 45(4) were not attracted an anomalous situation would arise and the provisions of Section 45(4) would stand

nullified to a greater extent. If the event of capital gain on dissolution of firm in the present case does not arise at the time when one of two partners is retiring, as is projected by the Id. counsel, we find that then no other occasion, before or after this dissolution would arise when the provisions of Section 45(4) could be made applicable. In-the light of the factual and legal position discussed above we hold that the CIT(A) was not justified in coming to the conclusion that provisions of Section 45(4) were not attracted to the facts of the case. His order on this issue is vacated.

13. Before parting with this issue we would like to deal with the decision of Apex Court in B.T. Patil & Son's case (supra) relied upon by the Id. counsel in his support. It is clearly distinguishable from the facts of the present case because there the distribution of assets by firm to partner was made during the subsistence of partnership firm and it was laid down that it amounted to deemed gift. We fail to see as to how this decision helps assessee on its facts. Further reliance on the decision of T. M. Louiz's case (supra) also does not come to the assessee's rescue because in that case the issue was liability under gift tax on retirement of partner from firm on account of transfer of his share to other partners. That was the case in which the issue was considered in the hands of partner as to whether there is any liability under Gift-tax Act or not. On the other hand, we are confronted with a situation where the provisions of Section 45(4) are considered in the hands of firm and there is no dispute before us as regards the liability of gift tax on retirement of one partner from the firm. This case also, in our considered opinion, does not support assessee's stand point. We therefore hold that Section 45(4) was clearly attracted in the present case.

14. After having held that the provisions of Section 45(4) are attracted, there remains one more issue to be decided as to whether the method adopted by the Assessing Officer for computing capital gain was correct or not. There is no dispute that the Assessing Officer at page 6 considered value of land as per Valuation Officer's report and by deducting the value shown in balance sheet determined capital gain under Section 50 at Rs. 3,77, 326. 50. In the like manner the capital gain was computed under Section 50 on building and machinery also. The Id. counsel has raised a contention that the valuation report was not correct

and the assessee had brought out various deficiencies in the report which were not considered by the Assessing Officer. From the order of the CIT(A) it is seen that he has not dealt with this issue.

As such we are of the considered opinion that it would be in the interest of justice if the impugned order on the issue of determining the fair market value is restored to the file of Assessing Officer for deciding it afresh after meeting with assessee's objection. We order accordingly.

15. The Id. counsel has also raised a contention that if at all the matter is to be remitted to the Assessing Officer for redetermining the fair market value then the Assessing Officer should be precluded from considering the value of land because he had referred to the provisions of Section 50 which were not applicable on land. From the assessment order it is noted that the Assessing Officer undoubtedly computed capital gains as per the provision of Section 50 by deducting the value of land as per balance sheet from the valuation of land as determined by the valuation officer in his report. No doubt that the Assessing, Officer resorted to application of Section 50 which was not correct in so far as land was concerned, but he was very much conscious of determining capital gain in terms of Section 45(4) on land as well.

Mere application of a wrong section can't, in our considered opinion, take away the jurisdiction of the Assessing Officer to correct it. It is only an irregularity which has arisen because of his wrong understanding. We find that the provisions of Section 292B would come to his aid because he only applied a wrong section but otherwise his action was in conformity with the intent of the relevant provisions. We are therefore not inclined to agree with this contention of the assessee.

16. With these remarks we restore the matter of valuation of land, building and machinery to the file of Assessing Officer by holding that the provisions of Section 45(4) are attracted to the facts of the case and direct him to compute capital gains as per law after affording a reasonable opportunity of being heard to the assessee.