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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Jun-15-2007

Judge : K Singhal, K Bansal

Appellant : ito

Respondent : Amitabh Singh

Judgement :

1. This appeal of the revenue arises out of the order of the Commissioner (Appeals)-XXVIII, New Delhi, passed on 1-8-2006. The corresponding assessment order was made by the Income Tax Officer, Ward 37(1), New Delhi, under the provisions of Section 143(3) of the Income Tax Act, 1961, on 17-3-2006. The only ground taken by the revenue in this appeal is that the learned Commissioner (Appeals) erred in deleting the addition of Rs. 32.50 lakhs made by the assessing officer on account of short-term capital gain by holding that the impugned amount was not assessable under any head of income. This also mentioned that he erred in holding that there was no transfer contrary to the fact that the assessee C retired from the partnership firm and the value of the goodwill was transferred and credited to his capital account.

2. In the assessment order, it is mentioned that a sum of Rs. 32.50 lakhs was credited in the capital account of the assessee on 31-5-2002 on account of goodwill of the firm. The opening balance in the capital account was Rs. 75,39,062, which increased to Rs. 1,09,38,517 on 31-5-2002 on account of various debits and credits. On 31-10-2002, two major amounts were debited. A

sum of Rs. 29.64 lakhs was paid to M/s.

Perfect Business Centre Services (P) Ltd. on behalf of the assessee-company and the balance amount of Rs. 71,14,380 was paid to the assessee. Thus, the whole of the amount standing to the credit of the assessee in the capital account with the firm was withdrawn. The assessee was required to show cause as to why the impugned amount of Rs. 32.50 lakhs should not be charged to tax as "capital gains". It was explained that since inception of the firm, it was a term of agreement between the partners that goodwill of the firm shall always belong to the firm and partners would not have any right, title or interest in the goodwill. New partners were sought to be admitted to the firm and, therefore, it was decided that the intangible assets of the goodwill of the firm should be brought into the books of the firm. The terms of partnership provided that upon retirement, an account would be taken and the retiring partner would be entitled to the balance laying to his credit in the capital account. Therefore, the assessee was paid the amount standing to his credit in the books of the firm. Upon retirement, the goodwill continued to remain the property of the firm.

It was further explained that what a retiring partner gets on retirement is his share, as held by Hon'ble Supreme Court in the case of Addl. CIT v. Mohanbhai Pamabhai . Thus, there was no transfer of any asset and no liability to capital gain. It was also explained that Circular No. 495, dated 22-9-1987 of the Board clarifies that the amendment made in Section 55 was with the view to cover only those cases where goodwill was actually transferred. Since the goodwill has not been transferred in this case, there was no question of the levy of capital gains tax. The assessing officer considered the facts of the case. It was mentioned that the assessee received a sum of Rs. 32.50 lakhs on 31-10-2002 in respect of his share in the goodwill credited in the books of the firm on 31-5-2002. It was further mentioned that the firm was re-constituted on 15-7-2002 whereby nine existing partners retired and eight new partners joined the firm. No information was brought on record as to whether on 31-5-2002, at the time of credit of the goodwill, any new partner was taken in by the: firm. Therefore, it cannot be said that goodwill was credited at the time of the re-constitution of the firm. The same was created two and half months prior to the re-constitution of the firm. On the facts, it was held

that the impugned amount received by the assessee was not his share in the past profits of the firm, remuneration for services rendered to the firm, gift from the firm, loan from the firm or share of profit from the firm. If this amount had been classified as remuneration interest or share of profit, then, the amount would have been liable to tax. The case of the assessee was based on the judgment of Apex Court in the case of Mohanbhai Pamabhai (supra), which was nullified by the amendment made to Section 55. Therefore, it was held that there has been a transfer at the time of actual payment in cash, leading to the taxation of the impugned amount as short-term capital gain.

3. The learned Commissioner (Appeals) referred to circular No. 495 and pointed out that it was clarified that the new provision will not apply to professional firm. The assessee was a partner in a firm of Chartered Accountants, i.e., a professional firm. There was also no actual transfer of goodwill as the same continued with the firm. The goodwill was created and credited to the accounts of the existing partners with a view to admit new partners in the firm and for this purpose the intangible asset of the firm was brought into the books. The assessee, being an individual, did not have any separate goodwill and, therefore, the question of transfer of goodwill to the firm does not arise.

Accordingly, the addition made by the assessing officer was deleted.

4. Before us, the learned DR referred to the facts regarding creation of goodwill in the books of the firm, retirement of the assessee from the firm and payment of the credit standing in his capital account. He also referred to the provision contained in Section 55(2)(a), which defines the cost of acquisition of intangible assets like goodwill, trademark or brand name associated with a business etc. It is inter alia provided that where such an asset has not been purchased from a previous owner, the cost of acquisition for the purposes of Sections 48 and 49 shall be nil He referred to the decision of Hon'ble Supreme Court in the case of Mohanbhai Pamabhai (supra), in which it was held that when a partner retires from a firm and receives his share, being an amount calculated on the value of the net assets of the firm including goodwill, there is no transfer of interest of the partner in goodwill and, therefore, nothing would be assessable as capital gain under Section 45 of

the Act. The case of the learned DR was that the amendment to Section 55 regarding cost of acquisition nullified the decision of the Hon'ble Court, with the result that the money received by a retiring partner in respect of his share in the goodwill of the firm became taxable. He also referred to Circular No. 495, in which it was inter alia mentioned that the intention in bringing to tax the capital gains on transfer of goodwill is only to cover those cases where goodwill is actually transferred. Those cases where the transfer is notional, for example, where a new partner is admitted to a firm, would not be covered by the amendment. The new provision will also not apply to a professional firm. He was of the view that the contents of the circular are somewhat vague and are not applicable to the facts of the case.

4.1 On the other hand, the learned Counsel for the assessee pointed out that the goodwill was brought into the books as the firm was to be reconstituted, having the effect of retirement of eight partners and joining in of nine new partners. The admission of the new partners may lead to notional transfer of the goodwill in their favour, but in such a case provisions of Section 55 will not apply, as mentioned in the beneficial Circular No. 495, referred to above. He relied on the decision of Hon'ble Supreme Court in the case of Mohanbhai Pamabhai (supra), which we have already referred to. Further, he relied on the decision of Hon'ble Supreme Court in the case of Tribhuvandas G. Patel v. CIT , in which it was held that a sum of Rs. 50,000 received by the assessee as his share in the goodwill of the firm was not assessable as capital gain. In this decision, the decision in the case of CIT v. B.C. Srinivasasetty (1981) 128 ITR 2941 (SC) was followed, in which it was held that where a partner retires and some amount is paid to him towards his share in the assets, it should be treated as the amount falling under Clause (ii) of Section 47. It may be pointed out that Section 47 (ii) was deleted from the statute by Finance Act, 1987, with effect from 1-4-1988. He also relied on the decision of Hon'ble Supreme Court in the case of CIT v. R. Lingmallu Raghukumar . The question before the Hon'ble court in that case was whether, on the facts and in the circumstances of the case, the excess amount of Rs. 46,500 received by the assessee on retirement from two partnership firms was assessable to capital gains? The Hon'ble court referred to its own decision in the case of Mohanbhai Pamabhai (supra) and in view of that judgment, it was held that there was no merit

in the appeal of the revenue. He also relied on the order of Hon'ble ITAT, Pune Bench (TM) in the case of Smt. Aruna A. Bhat v.Asstt. CIT (2002) 81 ITD 218, in which a reference was made to the decision of the Apex Court in the case of Mohanbhai Pamabhai (supra) to the effect that when a partner retires from a firm and receives his share of an amount calculated on the value of net partnership assets including goodwill of the firm, there was no transfer of interest of the partner in the goodwill and nothing would be assessable under Section 45 of the Act. The learned Counsel also clarified that nothing was charged from the incoming partner for the goodwill of the firm. On the basis of the aforesaid facts and arguments, his case was that the impugned amount was not at all taxable.

5. We have considered the facts of the case and rival contentions. The revenue's case is primarily based on the provision contained in Section 55(2) under which the cost of goodwill has to be taken at nil if it has not been purchased from a previous owner. Such is the case here.

Nonetheless, this cost is for the purpose of Sections 48 and 49, which deal with the mode of computation of the income chargeable under the head "Capital gains". Before coming to the mode of computation, it has to be seen whether any amount is chargeable to capital gains tax under Section 45,which is the charging section. The learned DR was not able to explain how provisions of Section 45 were applicable in the instant case. Sub-section (4) of this section deals with profits or gains arising from the transfer of a capital asset by way of distribution of capital asset on dissolution or otherwise of a firm, and brings to tax the capital gains in the hands of the firm. However, we are dealing with a case of the partner here. The firm acquired goodwill over a period of time, which was brought into the books and distributed amongst existing partners before the new partners were taken in and some existing partners retired. The asset of the firm already existed and it was quantified and credited to the accounts of existing partners. Similarly, when the assessee retired from the firm, he did not transfer any goodwill to the firm as he did not have any individual goodwill. The goodwill belonged to the firm and continued to remain with the firm. As clarified by the learned Counsel, nothing was charged from the incoming partners by way of goodwill and, thus, there is no question of even indirect realization of the value of goodwill by the assessee from

the incoming partner through the firm. In a number of cases, referred to above, it has been held that what a partner gets at the time of retirement is nothing but his own share in the assets of the firm. In such a scenario, there cannot be any transfer of an asset and such has been the decision of Hon'ble Supreme Court in the cases of Mohanbhai Pamabhai (supra) and Tribhuvandas G. Patel (supra). The fact is that a provision corresponding to Sub-section (3) regarding levy of capital gain tax when a. partner brings in a capital asset to the firm does not exist on the statute book in case of retirement of the partner and, thus, general provisions of law, namely, that what he takes is his share in the assets of the firm continues to apply with the exception that under Sub-section (4), when a capital asset is distributed to the partner on dissolution of the firm or on his retirement at less than the fair market value, then, the firm becomes liable to pay capital gains tax. Such is not the case here, as we are dealing with the case of a partner. Therefore, we concur with the learned Commissioner (Appeals) that nothing was taxable in the hands of the assessee.

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