C.I.T., U.P. A

v.

BANKEY LAL VAIDYA (DEAD) BY L.R.S.

January 21, 1971

[J. C. SHAH, C.J., K. S. HEGDE AND A. N. GROVER, JJ.]

Income-tax Act, 1922, *s.* 12*B*(1)—*Partition of assets of a firm on dissolution—Assets of firms valued—Outgoing partner paid value of his share—Whether transaction amounts to sale resulting in capital gain.* B

The respondent who was the karta of his Hindu undivided family entered into partnership with one D to carry on the business of manufacturing and selling pharmaceutical products etc. On July 27, 1946 the partnership was dissolved. The assets of the firm which included goodwill, machinery, furniture etc. were valued on the date of dissolution at C Rs. 2,50,000 and the respondent was paid the sum of Rs. 1,25,000 in lieu of his share and the business together with the goodwill was taken over by D. The question in income-tax proceedings was whether the transaction was one of sale liable to capital gains tax under s. 12B(1) of the Income-tax Act. 1922. The assessing and appellate authorities held against the respondent. The High Court in reference, however, held in his favour. The revenue appealed.

D

HELD : There was no clause in the partnership agreement providing for the method of dissolution of the firm or for winding up of its affairs. In the course of dissolution the assets of the firm may be valued and the assets divided between the partners according to their respective shares by allotting the individual assets or paying money value equivalent thereof. This is a recognised method of making up the accounts of the dissolved firm. In that case the receipt of money by a partner is nothing but a receipt of his share in the distributed assets of the firm. The respondent E received the money value of his share in the assets of the firm; he did not agree to sell, exchange on transfer his share in the assets of the firm. Payment of the amount agreed to be paid to the respondent under the arrangement of his share was therefore not consequence of any sale, exchange or transfer of assets. [408 C-E]

James Anderson v. *Commissioner of Income-tax, Bombay City*, 39 I.T.R. 123 and *Commissioner of Income-tax, Madhya Pradesh and Nagpur & Bhandara* v. *Dewas Cine Corporation*, 68 I.T.R. 240, distinguished. F

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1223 of 1967.

Appeal from the judgment and decree dated March 5, 1964 of the Allahabad High Court in Income-tax Reference No. 71 of 1959. G

S. K. Mitra, B. B. Ahuja, R. N. Sachthey and *B. D. Sharma*, for the appellant.

Ram Lal and *A. T. M. Sampat*, for the respondent.

The Judgment of the Court was delivered by

Shah, C.J. The respondent who is the *Karta* of a Hindu Undivided Family entered on behalf of the family into a partnership with one Devi Sharan Garg to carry on the business of H

A manufacturing and selling pharmaceutical products and literature relating thereto. On July 27, 1946 the partnership was dissolved . The assets of the firm which included goodwill, machinery, furniture, medicines, library and copyright in respect of certain publications were valued at the date of dissolution at Rs. 2,50,000/-. The respondent was paid a sum of B Rs. 1,25,000/- in lieu of his share and the business together with the goodwill was taken over by Devi Sharan Garg.

In proceedings for assessment of the respondent for the year 1947-48 the Income-tax Officer sought to bring an amount of Rs. 70,000/- to tax as capital gains. The contention raised by C the respondent that no part of the amount of Rs. 1,25,000/- received by the respondent represented capital gains was rejected by the Income-tax Officer, Appellate Assistant Commissioner and the Income-tax Appellate Tribunal. The Tribunal hiwever reduced the amounts capital gains brought to tax to Rs. 65,000/-. The Tribunal referred the following question to the High Court D of Allahabad under s. 66(1) of the Indian Income-tax Act, 1922 :

> "Whether on a true interpretation of sub-section (1) of section 12-B of the Income-tax Act, the sum of Rs. 65,000/- has been correctly taxed as capital gains".

E The High Court answered the question in the negative. Against that order, with certificate granted by the High Court, this appeal has been preferred.

Section 12-B(1), insofar as it is relevant provides :

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

Liability to pay capital gains arises under s. 12-B(1) if there be a sale, exchange or transfer of capital assets. There was no sale or exchange of his share in the capital assets of the firm by the respondent to Shri Devi Sharan Garg. Nor did he transfer his share in the capital assets. The assets of the firm included the goodwill, machinery, furniture, medicines library and the copyright in respect of certain publications. A large majority of the assets were incapable of physical division, and the partners agreed that the assets be taken over by Devi Sharan Garg at a valuation, and the respondent be paid his share of the value in money. Such an arrangement, in our judgment, amounted to a distribution of the assets of the firm on dissolution. There is no clause in the partnership agreement providing for the method of dissolution of the firm or for winding up of its affairs. In the course of dissolution the assets of a firm may be valued and the assets divided between the partners according to their respective shares by allotting the individual assets or paying the money value equivalent thereof. This is a recognized method of making up the accounts of a dissolved firm. In that case the receipt of money by a partner is nothing but a receipt of his share in the distributed assets of the firm. The respondent received the money value of his share in the assets of the firm; he did not agree to sell, exchange or transfer his share in the assets of the firm. Payment of the amount agreed to be paid to the respondent under the arrangement of his share was therefore not in consequence of any sale exchange or transfer of assets.

To persuade us to take a different view, reliance was placed on behalf of the Revenue upon *James Anderson* v. *Commissioner of Income-tax Bombay City*(1). In that case the assessee held a power of attorney from the executor of a deceased person, in the course of the administration of hise estate. He sold certain shares and securities belonging to the deceased for distribution among the legatees. The excess realized by sale was treated by the Income-tax Department as Capital gains. The contention of the assessee that since the sale of the shares and securities fell within the purview of the third proviso to s. 12-B(1) it could not be treated as a sale of capital assets within the meaning of s. 12-B(1) was rejected by this Court. This Court observed that the object of the third proviso to s. 12-B(1), in providing that "any distribution of capital assets under a will" shall not be treated as sale, exchange or transfer of capital assets for the purpose of s. 12-B was that as long as there was distribution of capital assets in specie and no sale, there was no transfer for the purposes of that section, but if there was a sale of the capital assets and profits or gains arose therefrom, the liability to tax

(1) 39 I.T.R. 123.

A arose, whether the sale was by the administrator or executor or a legatee, and that the expression "distribution of capital assets" in the third proviso to s. 12-B(1) meant distribution in specie and not distribution of sale proceeds. That case has no application. There was no distribution of capital assets between the legatees : the assessee had pursuant to the authority reserved to B him from the executor of the deceased person sold the shares and securities, and from the sale of shares and securities capital gains resulted. In the case in hand there is no sale and payment of price, but payment of the value of share under an arrangement for dissolution of the partnership and distribution the assets. The rights of the parties were adjusted by handing over to one of the C partners the entire assets and to the other partner the money-value of his share. Such a transaction is not in our judgment a sale, exchange or transfer of assets of the firm.

In *Commissioner of Income-tax, Madhya Pradesh, Nagpur & Bhandara* v. *Dewas Cine Corporation*(1) in dealing with the meaning of the expressions "Sale" and "sold" as used in s. (10) D (2)(vii) of the Income-tax Act, 1922, this Court observed that the expression "sale" in its ordinary meaning is a transfer of property for a price, and adjustment of the rights of the partners in a dissolved firm by allotment of its assets is not a transfer for a price. In that case the assets were distributed among the partners and it was contended that the assets must in law be deemed E to be sold by the partners to the individual partners in consideration of their respective shares, and the difference between the written-down value and the price realised should be included in the total income of the partnership under the second proviso to s. 10(2)(vii). This Court observed that a partner may, it is true, in an action for dissolution insist that the assets of the partnership be realised by sale of its assets, but property allotted to a F family in satisfaction of his claim to his share, cannot be deemed in law to be sold to him.

We therefore agree with the High Court that the question referred must be answered in the negative.

G The appeal fails and is dismissed with costs.

G.C. *Appeal dismissed.*

(2) 68 I.T.R. 240