IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD "C" BENCH

Before: Shri Waseem Ahmed, Accountant Member
And Shri T.R. Senthil Kumar, Judicial Member

ITA No. 1259/Ahd/2018
Assessment Year 2013-14

Shri Bipinbhai V. Patel Plot No. 588, Sector-22, Gandhinagar PAN: ACKPP7107R (Appellant)	Vs	The ITO, Ward-2, Gandhinagar (Respondent)

Assessee Represented: Shri M.K. Patel, A.R.
Revenue Represented: Shri Ashok Kumar Suthar, Sr.D.R.

Date of hearing : 26-07-2023
Date of pronouncement : 13-10-2023

आदेश/ORDER

PER : T.R. SENTHIL KUMAR, JUDICIAL MEMBER:-

This appeal is filed by the Assessee as against the appellate order dated 16.03.2018 passed by the Commissioner of Income Tax (Appeals), Gandhinagar arising out of the assessment order passed under section 143(3) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') relating to the Assessment Year (A.Y) 2013-14.

2. The brief facts of the case is that the assessee is an individual and was a Partner in the Partnership Firm M/s. Jyoti Quarry Works engaged in Quarry business. For the Assessment Year 2013-14, the assessee filed his Return of Income admitting total income of Rs. 59,93,510/- after claiming deduction under chapter VIA of Rs. 91,743/- and deduction u/s. 54F of Rs. 26,52,850/-. The assessee had relinquished its share from the Partnership Firm M/s. Jyoti Quarry Works along with other three Partners and the assessee received a sum of Rs. 70.38 lacs on his retire. Out of this the assessee made investment in a residential flat for Rs. 26,52,850/- and claimed deduction u/s. 54F of the Act. During the assessment proceedings, the assessee was issued show cause, why the claim u/s. 54F should not be disallowed, since the Relinquishment of a right in a Partnership Firm is not a capital asset within the meaning of section 2(14) of the Act.

2.1. In response, the assessee filed his reply letter dated 21-03-2016 observing as follows:

> *"Clarification in regard to deduction claim w's 54F of the act: during the year under consideration, the assessee had relinquished his share in firm - Jyoti quarry works and the capital gain derived therefrom were invested in residence premise, hence a deduction u/s. 54F claimed. In this connection your good self have raised the issue that deduction u/s 54F could be claimed against any other long term capital assets and thus relinquishment of right in firm would not be long term assets, hence the deduction will not be allowed.*
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> *In this connection, I would like to draw your attention towards the provision of section 2(14) of the act; which defines the capital assets. As per the said provision relinquishment of right in property would also a capital assets. In instant case the assesse became a partner in Jyoti quarry works w.e.f. dt. 01-04-2007 as per the deed. The firm had purchased certain land in surrounding area with a view to expansion of business, but the same had not been materialized. Further the said block of assets consistently shown in balance sheet on same amount and*

depreciation also not claimed. The copy of fixed assets chart from audit report for the preceding years enclosed herewith; which clearly indicates the same. So the joint right in said property would certainly a long term capital assets. In the circumstance, in our respectful view the assessee is entitled to deduction claimed w/s 54F."

2.2. The above explanation was not accepted by the Assessing Officer and held that Relinquishment of right in a Partnership Firm is not a capital asset, consequently no benefit of deduction u/s. 54F of the Act can be granted to the assessee. Thus the investment made in the new flat of Rs. 26,52,850/- is added as the income of the assessee.

3. Aggrieved against the same, the assessee filed an appeal before the Ld. CIT(A) who also dismissed the assessee appeal observing as follows:

"....4.2 I have considered the facts of the case, submission made by the appellant and the order of the AO. In this case, during the year under consideration, the appellant had claimed deduction u/s 54F of the Act amounting to Rs.26,52,850/-. It had been stated that he had received an amount on account of relinquishment of right in firm which was a capital asset and was invested in purchasing the flat, and therefore, he was entitled to the said deduction. The AO disagreed with his view and disallowed the amount of Rs.26,52,850/- claimed u/s. 54F of the Act. During the appellate proceedings, the appellant has reiterated the stand taken before the AO and has also relied on some case laws on the issue of extinguishment of rights in a firm.

I find from a perusal of the submissions made and the case laws relied on by the appellant that these are based on an entirely different set of facts. In the case laws relied upon by the appellant, the extinguishment of rights was on account of a Court Order or through a relinquishment agreement or when outgoing partners specifically surrenders their rights and interest in a firm when the same was taken over by some other partners. In this case, however, none of these facts are applicable. I have perused the reconstitution of partnership deed dated 03/04/2017 which simply states that the appellant is desirous of leaving the firm where he was a partner i.e. Jyoti Quarry Works, and that the remaining partners have agreed to let him leave w.e.f. 01/04/2012. There is no mention anywhere in the deed that the appellant is relinquishing any right in the firm or that he is leaving due to any other circumstances whereby he is giving up his rights to any of

the assets of the firm. This is a simple case where the appellant has retired from the firm, as mentioned in the deed."

In view of the discussion above, I do not agree with the submissions made by the appellant and the action of the rejecting the claim of the appellant u/s. 54F of the Act of Rs. 26,52,850/- is confirmed. Ground of appeal is dismissed.

4. Aggrieved against the same, the assessee is in appeal before us raising the following Grounds of Appeal:

1. The Ld. CIT (A) erred in law and on facts in sustaining the disallowance of deduction claim u/s. 54F of the Act, where the appellant had fulfilled all the conditions stipulated in said provision.

2. The Ld. CIT (A) erred on facts in upholding the addition made on assumption that, even after the retirement from firm the relinquishment of share/interest didn't ceased.

5. Ld. Counsel Shri M.K. Patel appearing for the assessee submitted before us it is not in dispute by the Assessing Officer, the receipt of Rs. 70,38,450/- on account of relinquishment of right on retire from the partnership firm M/s. Jyoti Quarry Works was a capital asset and in the computation of income, the Assessing Officer accepted the computation of capital gain. However when it comes to the claim of deduction u/s. 54F of Rs. 26,52,850/-, the same was denied on the ground that relinquishment of share from partnership firm is not a capital asset as a defined u/s. 2(14) of the Act. Even as per Section 2(14) of the Act capital asset means property of any kind held by the assessee whether or not connected with his business or profession but does not include stock-in-trade, raw materials held for the purpose of business or profession. Thus the Assessing Officer misconstrued the above provisions of law and the Ld. Counsel strongly relied upon Hon'ble Supreme Court Judgment in the case of CIT Vs. Mansukh Dyeing and Printing

Mills reported in [2022] 145 taxmann.com 151 (SC) and Hyderabad Tribunal decision in the case of Smt. Girija Reddy P. Vs. ITO (in ITA No. 297/Hyd/2012) dated 25.05.2012. Thus the Ld. Counsel submitted that the Lower Authorities are not correct in denying the benefit of deduction u/s. 54F of Rs. 26,52,850/- which is also arising out of the capital gain on relinquishment of right from the partnership firm. Therefore the appeal filed by the assessee is to be allowed.

6. Per contra, the Ld. Sr. D.R. Shri Ashok Kumar Suthar appearing for the Revenue supported the order passed by the Lower Authorities and prayed the same does not require any interference and the assessee liable to be dismissed.

7. We have given our thoughtful consideration and perused the materials available on record including the Paper Book and case laws filed by the assessee. It is seen from the computation of income by the Assessing Officer that the receipt of Rs. 70,38,450/- received by the assessee on relinquishment of his share from the partnership firm is treated as capital gain and computed the income thereon, but when it come for the claim of deduction u/s. 54F of the Act, the same was denied to the assessee on the ground that relinquishment of right from partnership firm is not a capital asset as per section 2(14) of the Act. As rightly pointed out by the Ld. Counsel as per Section 2(14) of the Act capital asset means property of any kind held by the assessee, whether or not connected with his business or profession, but does not include stock-in-trade, raw materials held for the purpose of business or

profession. The Ld. A.O. in the computation of income has accepted the receipt on relinquishment of his share from the Partnership Firm of Rs. 70,38,450/- as capital gain, but only denied the benefit of Section 54F of the Act, which in our considered opinion legally not correct. Our above view is supported by the following judicial precedents.

7.1. The Hon'ble Supreme Court in the case of Mansukh Dyeing and Printing Mills (cited supra) held as follows:

> *"Section 45, read with sections 2(47) and 147, of the Income-tax Act, 1961 Capital gains Chargeable as (Firm, in case of) Assessment years 1993-94 and 1994-95 Whether word "otherwise used in section 45(4) takes into its sweep not only cases of dissolution but also cases of subsisting partners of partnership, transferring assets in favour of a retiring partner-Hald, yes Assessee-partnership firm was reconstituted and new partners were admitted - Later, assets of firm were revalued and revalued amounts were credited to accounts of partners in their profit sharing ratio-Assessing Officer opined that assessee enhanced value of assets by revaluing land and building, and subsequent crediting of enhanced revalued amount to respective partners capital accounts would constitute transfer - He, thus, passed reassessment order holding that said amount would be liable to be taxed under section 45(4) and accordingly, made addition towards short-term capital gains Whether revalued amount which was credited to partner's account in their profit sharing ratio and credit of assets revaluation amount to capital accounts of partners could be said to be in effect distribution of assets to partners - Held, yes - Whether since amount credited to capital accounts of partners was available for withdrawal, assets so revalued and credited to capital accounts of respective partners could be said to be transfer' which would fail in category of 'otherwise' and provision of section 45(4) would be applicable - Held, yes [Paras 7.3 and 7.5] [In favour of revenue*]"

7.2. The Hon'ble Supreme Court has affirmed that the decision of the Bombay High Court in the case of CIT Vs. A.N. Naik Associates 265 ITR 346 (Bom) wherein it was held as follows:

> *....7.4 However, in view of the amended section 45(4) of the Income-tax Act inserted vide Finance Act, 1987, by which. "OR OTHERWISE" is specifically added, the aforesaid submission on behalf of the assessee has no substance. The Bombay High Court in the case of 4.N. Naik Associates*

(supra) had an occasion to elaborately consider the word "OTHERWISE" used in section 45(4). After detailed analysis of section 45(4), it is observed and held that the word "OTHERWISE used in section 45(4) takes into its sweep not only the cases of dissolution but also cases of subsisting partners of a partnership, transferring the assets in favour of a retiring partner. While holding so, it is observed in paragraphs 14, 21, 22 and 24 as under:-

> *"14. Pursuant to the inclusion of sub-section (4) in section 45, on the dissolution of a partnership the profits or gains arising from the transfer of capital asset are chargeable to tax as income of the firm. It is contended on behalf of the assessee that even after introduction of section 45(4), the position will be the same as the definition clause se namely section 2(47) has not been amended. Secondly it is contended that the expression "otherwise" must be read edjusdem generis with the expression dissolution of firm. So considered, there is no dissolution on the firm. So considered, there is no dissolution on the facts of the case. On behalf of the revenue, it was, however, argued that the amendment was brought about to remove the mischief occasioned by parties avoiding to pay tax, considering the law as declared and to plug the loopholes. The expression otherwise must be read to mear transfer of capital assets of the assessee firm include to a partner. As the section is a self-contained code, there was no need to amend the definition of transfer under section 2(47) of the Act. The Position therefore, will have to be examined in the context of the law as amended after 1988.....*
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> *21. With the above, we may now proceed to answer the issue. On retirement of a partner or partners from an existing firm, and who receives assets from the firm, the law before 1998 would really be of no support, as by section 45(4) what was otherwise not taxable has been made taxable. Section 45(4) seems to have been introduced with a view to overcome the judgment of the Apex Court in Malabar Fisheries Co. v. Commissioner of Income Tax, Kerala (supra) and other judgments which took a view that the firm on its own has no right but it is the partners who own jointly or in common the asset and thereby remedy the mischief occasioned. Distribution of capital assets on dissolution now is subject to capital gains tax unless it does not fall within the definition of transfer under section 2(47) What would be the effect of partners of a subsisting partnership distributing assets to partners who retire from the partnership. Does the asset of the partnership, on being allotted to the retired partner/partners fall within the expression "otherwise". As noted earlier on behalf of the assessee it has been contended that the expression "otherwise" would have to be read*

"ejusdem generis" with "dissolution of partner or body of individuals" and for that purpose reliance was placed on a judgment of the Division Bench in (Commissioner of Income-Tax, Bombay City II v. Trustees of Abdulcadar Ebrahim Trust). 1975 (100) LTR. 85. Section 45 is a charging section. The purpose and object of the Act of 1988 was to charge tax arising on distribution of capital assets of firms which otherwise was not subject to taxation. If the language of sub-section (4) is construed to mean that the expression "otherwise" has to partake in the nature of dissolution or deemed dissolution, then the very object of the amendment could be defeated by the partners, by distributing the assets to some partners who may retire. The firm then would not be liable to be taxed thus defeating the very purpose of the Amending Acts. Prior to the Finance Act, 1987 in case of a partnership it was held that the assets are of the partners and not of the partnership. Therefore if on retirement a partner receive his share of the assets, may be in the form of a single asset, it was held that there was no transfer and similarly on dissolution of the partnership. Another device resorted to by an assessee was to convert an asset held independently as an asset of the firm in which the individual was a partner. The decision of the Supreme Court in (Kartikeya v. Sarabhai v C.I.T), 1985 (156) LTR. 509 took a view that this would not amount to transfer and, therefore, fell outside the scope of capital gain. The rationale being that the consideration for the transfer of the personal asset was indeterminate, being the right which arose or accrued to the partner during the subsistence of the partnership to get his share of profit from time to time and on dissolution of the partnership to get the value of his share from the not partnership asset. Parliament with the avowed object of blocking this escape route for avoiding capital gains tax by the Finance Act, 1987 has introduced sub-section (3) of section 45. The effect of this was that the profits and gains arising from the transfer of a capital asset by a partner to a firm is chargeable as the partner's income of the previous year in which the transfer took place. On a conversion of the partnership assets into individual assets on dissolution or otherwise also formed part of the same scheme of tax avoidance. To plug these loophole the Finance Act, 1987 brought on the statute book a new sub-section (4) in section 45 of the Act. The effect is that the profits or gains arising from the transfer of a capital asset by a firm to a partner on dissolution or otherwise would 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 would be deemed to be the full value of the consideration received or accrued as a result of transfer. Therefore, if the object of the Act is seen and the mischief it seeks to avoid, it would be clear that intention of Parliament was to bring into the tax not transactions whereby assets were brought into a firm or taken out of the firm.

> *22. The expression "otherwise" in our opinion, has not to be read ejusdem generis with the expression. dissolution of a firm or body or assets of persons. The expression "otherwise" has to be read with the words 'transfer of capital assets" by way of distribution of capital asset's. If so read, it becomes clear that even when a firm is in existence and there is a transfer of capital assets it comes within the expression "otherwise" as the object of the amending Act was to remove the loophole which existed whereby capital gain tax was not chargeable. In our opinion, therefore, when the asset of the partnership is transferred to a retiring partner the partnership which is assessible to tax ceases to have a right or its right in the property stands extinguished in favour of the partner to whom it is transferred. If so read it will further the object and the purpose and intent of amendment of section 45. Once, that be the case, we will have to hold that the transfer of assets of the partnership to the retiring partners would amount to the transfer of the capital assets in the nature of capital gains and business profits which is chargeable to tax under section 45(4) of the 1.T. Act. We will, therefore, have to answer question No. 3 by holding that the word "otherwise" takes into its sweep not only the cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of a retiring partner."*

7.3. Further the Co-ordinate Bench of the Hyderabad Tribunal in the case of Smt. Girija Reddy P. (cited supra) held as follows:

> *49. Thus, in our opinion, it was a case of lump sum payment in consideration of the retiring partner assigning or relinquishing her share or right in the partnership and its assets in favour of the continuing partners. We are of the view that the manner of the retirement in case of the assessee is such that it can be regarded as assigning or relinquishing by the retiring partner of her share or right in the partnership firm and its assets in favour of the continuing partners. Therefore, we are of the view that the assessee satisfies the parameters laid down by the Bombay High Court in the cases referred to above and, therefore, there was a transfer of interest of the retiring partner over the assets of the partnership firm on her retirement and, therefore, there was a liability to tax on account of capital gain.*

8. Respectfully following the above judicial precedents, we have no hesitation in holding the receipt of Rs. 70,38,450/- on relinquishment of assessee's share from partnership firm is a capital gain wherein the claim of reinvestment on residential flats of

Rs. 26,52,000/- is an allowable claim deduction under section 54F of the Act. Therefore the disallowance made by the Lower Authorities are hereby set aside. Thus the grounds raised by the Assessee is hereby allowed.

9. In the result, the appeal filed by the Assessee is allowed.

Order pronounced in the open court on 13-10-2023

Sd/- **Sd/-**
(WASEEM AHMED) **(T.R. SENTHIL KUMAR)**
ACCOUNTANT MEMBER True Copy JUDICIAL MEMBER
Ahmedabad : Dated 13/10/2023

आदेश की प्रतिलिपि अग्रेषित / Copy of Order Forwarded to:-

1. Assessee
2. Revenue
3. Concerned CIT
4. CIT (A)
5. DR, ITAT, Ahmedabad
6. Guard file.

By order/आदेश से,

उप/सहायक पंजीकार
आयकर अपीलीय अधिकरण,
अहमदाबाद