Bombay High Court Commissioner Of Income-Tax vs A.N. Naik Associates And Anr. And ... on 23 July, 2003 Equivalent citations: (2004) 187 CTR Bom 162, 2004 265 ITR 346 Bom Author: F Rebello Bench: F Rebello, P Hardas JUDGMENT F.I. Rebello, J. 1. Both these appeals can be disposed of by a common order as the facts involved are the same and similar questions of law arise. The respondents hereto were parties to a family settlement dated January 30, 1997. Pursuant to the said family settlement, there was a deed of reconstitution of various partnerships as set out under the family settlement. For the assessment year 1997-98, the partnerships were taxed for capital gains under Section 45(4) of the Income-tax Act, 1961. An appeal was preferred against the said order by the assessee which came to be dismissed by the appellate authority by order dated June 16, 2000. An appeal was then preferred to the Income-tax Appellate Tribunal, by the assessee. The appeal was allowed. The Income-tax Appellate Tribunal held that there was no dissolution but only reconstitution. The Income-tax Appellate Tribunal also held that the expression "otherwise" had to be read ejusdem generis and would contemplate situations like a deemed dissolution and consequently held that tax on capital gains was not chargebale. On the facts, it was held that the business continued to be run and there was no dissolution of the firm and consequently Section 45(4) of the Act was not attracted. 2. The present appeals are preferred by the Revenue and various questions were framed. At the time of hearing, however, the following questions of law have been formulated for consideration which are as under : "1. Whether the deed of family settlement dated January 30, 1997, amounts to dissolution of partnership formed by agreement as contemplated under Section 40 of the Indian Partnership Act ? 2. Whether the distribution of assets of the firm amongst the retiring partners dated January 30, 1997, and the deed of reconstitution dated January 30, 1997, would amount to transfer of the capital assets which is in the nature of capital gains and business profits chargeable to tax under Section 45(4) of the Income-tax Act ? 3. Whether the word 'otherwise', in Section 45(4) takes into its sweep not only cases akin to dissolution of the firm but also cases of reconstitution of firm ? 4. Whether the deed of reconstitution of partnership by the assessee-firm is a device to avoid tax ? 5. Whether, on the facts and circumstances of the case, the Income-tax Appellate Tribunal was justified in law in setting aside the assessment order by holding that there is no dissolution ?" 3. By the memorandum of family settlement dated January 30, 1997, it was agreed between the parties thereto, that business of six firms as set out therein would be distributed in terms of the family settlement as the parties desired that various matters concerning the business and assets thereto be divided separately and partitioned. The deed also recited that resorting to civil suits would damage the family since the entire business is a family business, the nucleus having been inherited. Under the terms and conditions of the settlement, it was set out that the assets which are proposed to be divided in partition under the settlement are held by the aforesaid firms and individual partners. With reference to the firms, the manner in which the firms were to be reconstituted by retirement and admission of new partners was also set out. It also provided that such of those assets or liabilities belonging to or due from any of the firms allotted to parties thereto in the schedule annexed shall be transferred or assigned irrevocably and possession made over and all such documents, deeds, declarations, affidavits, petitions, letters and alike as are reasonably required by the party entitled to such transfer would be effected. It is based on this document and the subsequent deeds of retirement of partnership that the order of assessment was made holding that the appellants are liable for tax on capital gains. 4. The relevant portion of Section 45, with which we are concerned is Sub-section (4) which reads as under : "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 co-operative 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." Sub-section (4) along with Sub-section (3) were introduced by the Finance Act, 1987, with effect from April 1, 1988. From a reading of the above subsection to attract capital gains what would be required would be as under : "1. Transfer of capital asset by way of distribution of capital assets : (a) On account of dissolution of a firm ; (b) Or other association of persons ; (c) Or body of individuals ; (d) Or otherwise ; shall be chargeable to tax as the income of the firm, association or body of persons." 5. On behalf of the Revenue, it is contended that the deed of family settlement dated January 30, 1997, amounts to dissolution of the partnership and the distribution of assets amongst the partners, even if it may be, by entries in the books, would amount to transfer of capital assets, to which the provisions of Section 45(4) would be attracted. Independently, it is contended that even if there be no dissolution the expression "otherwise" would have to be read to mean any transfer of assets of the firms in favour of any of the partners. It is also contended that the deed of reconstitution of partnership by the assessee-firm was merely a device to avoid tax and the court should not encourage the same. In these circumstances, it is contended that the order in appeal be set aside and the reference answered in favour of the Revenue. On behalf of the Revenue, learned counsel for the Revenue from the deed of family settlement drew our attention to various terms wherein apart from some of the assets remaining with the firm, assets of the firm were allotted as part of the settlement to other partners. Reliance is placed on various judgments which would be adverted to in the course of the discussion. 6. On the other hand, on behalf of the assessee/respondents, it is contended that there was no dissolution of the firm nor discontinuance of business at any point of time. The registration of the firm continues to be the same. The written agreement would show that the partnership continued without dissolution. The business of the firm continued without any closing and assets of the firm remained with the partners without disruption. Family settlement in law does not result in transfer of assets or transfer of interest in property. The schedule of allocation of assets clearly states that a firm shall be taken over by the partners named therein. Even otherwise, the family arrangements arrived at did not suggest that there should be dissolution of the firm. Reliance has also been placed on various judgments which will be adverted to in the course of the discussion. 7. With the above, we may now proceed to answer the questions as formulated. Section 45 is the charging section. Under Section 45, there must be a transfer of a capital asset by way of distribution of assets in the first instance. Capital asset under Section 2(14) of the Income-tax Act, 1961, has been defined to mean property of any kind held by an assessee. In other words, the property transferred must fall within the ambit of capital asset. The next relevant section is the expression "transfer" as set out in Section 2(47) which in relation to a capital asset includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein. We need not refer for the present discussion to the other part of the said definition. Therefore, transfer will also include relinquishment of the asset or extinguishment of any rights therein. 8. We first propose to answer the issue whether the deed of family settlement dated January 30, 1997, amounts to dissolution of the partnership firm by agreement under Section 40 of the Indian Partnership Act. The Revenue has firstly placed reliance in the case of Erach F.D. Mehta v. Minoo F.D. Mehta, . There the apex court held on the facts therein that the agreement that one of the partners will retire amounts to dissolution of the partnership. In that case there were only two partners. The facts in our case are different. In Mir Abdul Khaliq v. Abdul Gaffar Sheriff, , the apex court held on the facts that the documents clearly showed that not only the named partner had retired from the partnership but, the firm consisting of three partners was dissolved on the date on which the partner was intimated. In that case, one of the persons had sent a letter to the bank intimating retirement of named partner and requesting for closing the account of the firm and opening a new account. It was on those facts that it was held that there was both retirement and dissolution of the partners. In the instant case, the documents would clearly show that before, the continuing partners retired there was an induction of a new partner in the morning of the said day and the outgoing partners retired at the closing of business hours on that day. In other words, the partnership subsisted but with two partners and the business also continued. That would, therefore, not amount to dissolution of the firm and clearly, therefore, the order of the Income-tax Appellate Tribunal cannot be faulted. It has recorded a finding that there is no dissolution of the partnership as contemplated under Section 40 of the Indian Partnership Act. 9. Before addressing ourselves to issues Nos. 2 and 3, we may now consider whether the deed of reconstitution by the parties of the assessee-firm is a device to avoid tax. It is contended that in fact it is the family settlement under which the assets have been transferred and the purported deed of reconstitution is merely a device to avoid tax and in that context, reliance is placed on a judgment of the apex court in McDowell and Co. Ltd. v. CTO [1985] 154 ITR 148. The apex court therein had observed as under (page 160): "We must recognise that there is behind taxation laws as much moral sanction as behind any other welfare legislation and it is a pretence to say that avoidance of taxation is not unethical and that it stands on no less a moral plane than honest payment of taxation. In our view, the proper way to construe a taxing statute, while considering a device to avoid tax, is not to ask whether the provisions should be construed literally or liberally, nor whether the transaction is not unreal and not prohibited by the statute, but whether the transaction is a device to avoid tax, and whether the transaction is such that the judicial process may accord its approval to it. A hint of this approach is to be found in the judgment of Desai J. in Wood Polymer Ltd., In re and Bengal Hotels limited, In re [1977] 109 ITR 177 ; [1977] 47 Comp Cas 597 (Guj), where the learned judge refused to accord sanction to the amalgamation of companies as it would lead to avoidance of tax. It is neither fair nor desirable to expect the Legislature to intervene and take care of every device and scheme to avoid taxation. It is up to the court to take stock to determine the nature of the new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices could be related to the existing legislation with the aid of 'emerging' techniques of interpretation as was done in Ramsay, Burma Oil and Dawson, to expose the devices for what they really are and to refuse to give judicial benediction." 10. This issue was an issue before the Income-tax Appellate Tribunal. The Income-tax Appellate Tribunal has held that the firm was in existence right from 1985 and it was not a device to avoid tax. It was noted that there was no denial that there were family disputes amongst the partners and the genesis of family arrangement was not disputed. The arrangement by way of division of the assets and business interest was clearly defined and were not an isolated transaction in respect of the appellant firms. The Tribunal noted that from the memorandum of family arrangement, there was no contemplation of dissolution of the firm but reconstitution of the firm. The saving of tax was only a consequence of a normal event. We are in agreement with the view taken that the family settlement only provides the manner in which the assets of the family would be separated. The settlement itself contemplated various steps to be taken for giving effect to the family settlement. In our opinion, therefore, the finding by the Income-tax Appellate Tribunal that the deed of reconstitution by inducting a partner in the assessee-firm was not a device to avoid tax has to be upheld. 11. That leads us to the questions formulated under numbers, 2, 3 and 5, which will be required to be answered together. Let us examine whether a family settlement amounts to a transfer, The law on the subject is no longer res integra. In Ram Charan Das v. Girja Nandini Devi, , the apex court noted that a consideration for a family settlement is the expectation that such a settlement will result in establishing or ensuring amity and goodwill amongst the relations and that a family settlement does not amount to a transfer as in the family arrangement each party takes a share in the property by virtue of the independent title which is admitted to that extent by the other parties. Every party who takes benefit under it need not necessarily be shown to have a share in the property. All that is necessary to show is that the parties are related to each other in some way and have a possible claim to the property or a claim or even a semblance of a claim on some other ground as say affection. 12. The position in law in respect of transfer of assets of a subsisting partnership to a partner as his share or on dissolution of the firm before its amendment needs now to be considered. Let us first consider the judgment of the apex court in Malabar Fisheries Co. v. CIT [1979]

120 ITR 49. In that case, there was a dissolution of firm and distribution of assets. The issue was whether the same amounts to transfer within the meaning of Section 2(47) of the Income-tax Act, 1961. The apex court considered the definition of expression “transfer” under Section 2(47) and noted that Section 2(47) gives an artificial meaning to the expression “transfer” for it not merely includes transactions of “sale” and “exchange” in ordinary parlance but would also mean “relinquishment” or “extinguishment of rights” which are ordinarily not included in that concept. In that context, the apex court posed the question whether the dissolution of a firm extinguishes the firm’s rights in the assets of the partnership so as to constitute a transfer of assets under Section 2(47). After considering various judgments and the provisions of the Indian Partnership Act, the court observed that a partnership under the Indian Partnership Act is not a distinct entity. If that be the position, the apex court noted it would be difficult to accept the contention that upon dissolution the firm’s rights in the partnership assets are extinguished. The firm as such has no separate rights of its own in the partnership assets but it is the partners who own jointly or in common the assets of the partnership. Therefore, the consequence of the distribution, division or allotment of assets to the partners which flows upon dissolution after discharge of liabilities is nothing but a mutual adjustment of rights between the partners and there is no question of any extinguishment of the firm’s rights in the partnership assets amounting to a transfer of assets within the meaning of Section 2(47) of the Act. Proceeding further, the court observed that every dissolution must be anterior to the actual distribution, division or allotment of the assets that takes place after making up accounts and discharging the debts and liabilities due by the firm and thereupon distribution, division or allotment of assets takes place. The distribution to the partners is not done by the dissolved firm and in that sense there is no transfer of assets by the assessee to any person. In CIT v. B. C. Srinivasa Setty [1981] 128 ITR 294, the apex court was considering the question whether goodwill generated in a newly commenced business cannot be an “asset” within the meaning of Section 45 of the Income-tax Act, 1961. Considering the provisions of Section 45(1) as it then stood and the definition of “capital asset” in Section 2(14) the court came to the conclusion that goodwill generated in a newly commenced business cannot be described within the terms of Section 45 and, therefore, its transfer is not subject to income-tax under the head “Capital gains”. In CIT v. P. Lingamullu Raghukumar , in respect of an order of the Andhra Pradesh High Court dated July 21, 1982, CIT v. L. Raghu Kumar [1983] 141 ITR 674, the apex court once again reiterated that there is no element of transfer of interest in the partnership assets by the retired partner to the continuing partners. Reliance for that was placed in the judgment of CIT v. Mohanbhai Pamabhai [1973] 91 ITR 393 (Guj) which had been affirmed by the apex court and the judgment reported in Addl. CIT v. Mohanbhai Pamabhai [1987] 165 ITR 166. The Gujarat High Court had taken the view that when a retired partner receives a share of amount calculated on the value of the net goodwill of the firm there was no transfer of interest of the partner in the goodwill and no part of the amount received by him would be assessed as capital gain under Section 45 of

the Income-tax Act, 1961. 13. It may be noted that all these judgments were previous to the amendment brought about by the Act of 1987 which introduced Sub-sections (3) and (4) in Section 45, with effect from April 1, 1988. Those judgments proceeded on the footing that a partnership firm is not a distinct legal entity and the partnership property in law belongs to all the partners constituting the firm, though the partnership firm may possess a personality distinct from the persons constituting it and, therefore, on dissolution, as the firm has no separate rights of its own in the partnership assets, the consequence of distribution, division or allotment of assets of the partners which flows upon dissolution after discharge of liabilities is nothing but a mutual adjustment of rights between the partners and there is no question of any extinguishment of the firm's rights in the partnership assets amounting to a transfer of assets within the meaning of Section 2(47) of the Act. 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, i.e., namely, Section 2(47), has not been amended. Secondly, it is contended that the expression "otherwise" must be read ejusdem generis with the expression dissolution of 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 include transfer of capital assets of the assessee-firm 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. Before elaborating on the issue we may examine some judgments relied upon to find out, whether they are of assistance in answering the issue. 15. Our attention was invited to a judgment in A.L.A. Firm v. CIT . A perusal of the said judgment would clearly show that what was an issue in that case is really not an issue in this case. What was really an issue in that case was the valuation of the stock-in-trade on dissolution of the firm. In Sakti Trading Co. v. CIT , the issue was whether on dissolution or death of one partner and reconstitution with the remaining partners without discontinuance of business how the valuation on the closing stock should be done. This judgment again in our opinion, also does not assist us in consideration of the issue which is before us. In Sunil Siddharthbhai v. CIT , the issue was as to what happens when the assessee brought the shares of the limited companies into the partnership firm as his contribution to its capital and whether there was a transfer of a capital asset within the meaning of Section 45 of the Income-tax Act. It was answered in the affirmative as when the assessee transferred his shares to the partnership firm he received no consideration within the meaning of Section 48 of the Income-tax Act, 1961, nor did any profit or gain accrue to him for the purpose of Section 45 of the Act, because the consideration received by the assessee on the transfer of his shares to the partnership firm does not fall within the contemplation of Section 48 and no profit or gain can be said to arise for the purposes of the Act. The apex court considered two situations, one when a personal asset is brought by a partner into a partnership as his contribution to the partnership capital and that which arises when on dissolution of the firm or on retirement a share in the partnership assets passes to the partner. The court held that on dissolution or on retirement what the partner gets is a shared interest in all the assets of the firm which is replaced by an exclusive interest in an asset of equal value. This judgment was in respect of an assessment before the amendment to Section 45. In CIT v. Vijayalakshmi Metal Industries , the real issue before the learned single judge was as to when capital gain is to be brought to tax. The learned judge held that until such time such capital asset is transferred by way of distribution of the assets on the dissolution of the firm no occasion arises for bringing to tax any capital gain on a transfer which has not taken place. The section itself gives no room for doubt as the year in which the capital gain is to be brought to tax is the previous year in which the said transfer takes place. This judgment would again be of no assistance. In CIT v. Kunnamkulam Mill Board the assessment was for the year 1989-90. In that case, the real controversy was whether by retirement of a partner of the firm there is a transfer of the assets of the firm in favour of the surviving partners within the meaning of Section 45(4) of the Act. The Division Bench of the Kerala High Court answered the same in the negative by holding that there was no transfer of assets, by holding that as long as there is no change in ownership of the firm and its properties, there is no transfer of ownership on reconstitution of the firm. This is therefore, not a case, where the assets were allotted to a retiring partner. 16. Reliance has been placed in a judgment of the apex court in CGT v. N.S. Getti Chettiar [1971] 82 ITR 599 to understand the expression "transfer". It is observed therein that in spelling out the meaning one must take into consideration the setting in which those terms are used and the purpose that they are intended to serve. If so understood, it is clear that the word "disposition", in the context, means giving away or giving up by a person of something, which was his own. Assignment means the transfer of the claim, right or property to another. In that case, the court held that a partition in a Hindu undivided family can be considered either as "disposition" or "conveyance" or "assignment" or "settlement" or "delivery" or "payment" or "alienation". It is no doubt true that on behalf of the assessee, their learned counsel has placed reliance in Tribhuvandas G. Patel v. CIT . Firstly, in that case, the matter pertains to an assessment before the Amendment Act came into force in 1988. The issue was in respect of the retirement of a partner from a partnership. The real issue in that case was whether a partner who has retired and had received his share of the assets would be liable to be taxed under Section 47. 17. We may now consider the judgment in B.T. Patil and Sons v. CGT . We will advert to some facts. In that case, the issue before the Division Bench of the Karnataka High Court was, charging of gift-tax. In that case there was a firm with five partners which owned several assets in the form of machinery. Certain debits were made to the respective accounts in July, 1977, stated to be the value of certain machinery distributed by the firm to the partners. Some machinery was given to the partners individually and one machine was given to all the five partners to be held by them jointly as co-owners. As a result, the firm ceased to be the owner of the said machinery and the five partners became the owners of the machinery so distributed either individually or as co-owners. The five partners shortly thereafter formed another partnership and contributed the machinery which was distributed to them by the assessee-firm to the new firm by doing valuation. The new firm thereafter sold the machinery for a price. The Gift-tax Officer treated the difference at the price at which the machinery was distributed by the assessee-firm to its partners as deemed gift and subjected the same to gift-tax. The issue was whether distribution of machinery was a transfer in the nature of sale, for a consideration. The Division Bench of the Karnataka High Court considered the expression of "transfer" under Section 2(xxiv) of the Gift-tax Act, which defines "transfer of property" as any disposition, conveyance, assignment, settlement, delivery or other alienation of property. The Division Bench noted that the Act was self-contained and the definition of "property" is to rope in artificial devices which may include mere agreements or arrangements, intended to confer gifts, which may not however, fall under the normal meaning of "transfer" as gifts and the definition of "gift" in Section 2(xii) to include many transactions which could not ordinarily be described as transfers of property and has a wider import than the meaning given to "gift" in Section 122 of the Transfer of Property Act. The court after considering various judgments, held that the decisions which hold that there is no transfer of property when there is a distribution of assets on dissolution or when an asset is allotted to a partner on his retirement from the firm, will be inapplicable where an asset is brought in by the partner into the partnership. The court then observed that it follows therefrom that they will be inapplicable, even in a converse situation where a firm distributes or gives its assets to its partner by debiting the value thereof to the respective partner's account, without there being either dissolution or retirement. The court noted that while dealing with the value of interest of each partner qua an asset cannot be isolated or carved out from the value of the partner's interest in the totality of the partnership assets, once it is allotted, it becomes the individual property of the partner. The court then proceeded to hold that, thus, the shared interest becomes the exclusive interest of a partner. When an asset of the firm is allotted to a partner during the subsistence/continuation of the partnership firm (as contrasted from an allotment on dissolution of the firm or retirement of the partner), the shared interest of all the partners in the said asset, is replaced by the exclusive interest of the allottee, for consideration. To that extent, there is an extinguishment of the interests of the other partners of the firm, in the partnership asset in question and enlargement of the limited interest of the allottee into a full exclusive right in the asset. When the asset is a partnership asset, a partner cannot claim or exercise any specific share or right over such asset to the extent of his share in the business of the partnership (as a co-owner can do in respect of a co-ownership property), as his right during the subsistence of the partnership is only to get his share of profits. But, on allotment of the asset by the firm to the partner, such partner becomes entitled to exercise over the asset, all rights of an absolute owner. The court then proceeded to observe what was a mere interest on allotment by the firm, enlarges into an absolute right, title and interest. The extinguishment of the common interest of the partners of the firm and creation of absolute ownership of the partner to whom it is allotted. Such a transaction is, therefore, a transfer of property as defined in the Gift-tax Act. We may note that the partnership was subsisting and an asset of the partnership was made the absolute ownership of one of the subsisting partners. 18. This judgment came up for consideration before the apex court in B.T. Patil and Sons v. CGT [2001] 247 ITR 588 upholding the judgment of the Karnataka High Court. The apex court observed as under (page 591) : "In our view, when there is a dissolution of a partnership or a partner retires and obtains in lieu of his interest in the firm, an asset of the firm, no transfer is involved .. . But the position is different when, during the subsistence of a partnership, an asset of the partnership becomes the asset of only one of the partners thereof ; there is, in such a case, a transfer of that asset by the partnership to the individual partners." 19. The ratio of the judgment as can be culled out is that when a subsisting partner receives from the firm an asset then there is a transfer of that asset from the partnership to the individual partner. In other words under the Wealth-tax Act when an asset of the partnership becomes the asset of one of the partners it amounts to a transfer. 20. Before proceeding to further examine the matter, we may consider the judgment in N. Bagavathy Ammal v. CIT . The apex court therein took the view that in construing the provisions of Section 46(2) of the Income-tax Act, 1961, the definition of "capital asset" in Section 2(14) had no relevance. In that case, no doubt what was in issue was Section 46(2) and what the apex court was considering there was the distinction between "transfer of assets" and the distribution of the assets of the company under liquidation. The court also observed that Section 46(2) is in terms an independent charging section and also provides for a distinct method of calculating capital gains. 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 1988 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. CIT [1979] 120 ITR 49 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 partnership or body of individuals" and for that purpose reliance was placed on a judgment of the Division Bench in CIT v. Trustees of Abdulcadar Ebrahim Trust [1975]

100 ITR 85 (Bom). Section 45 is a charging section. The purpose and object of the Act of 1987 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 of 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 Act. Prior to the Finance Act, 1987, in the 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 received 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. CIT [1985] 156 ITR 509 took a view that this would not amount to transfer and, therefore, fell outside the scope of the 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 net 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) to 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 are 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 this 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 the transfer. Therefore, if the object of the Act is seen and the mischief it seeks to avoid, it would be clear that the intention of Parliament was to bring into the tax net transactions whereby assets were brought into a firm or taken out of the firm. 21. The expression “otherwise” in our opinion, has not to be read ejusdem generis with the expression, “dissolution of a firm or body or association of persons”. The expression “otherwise” has to be read with the words “transfer of capital assets” by way of distribution of capital assets. 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 assessable 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 the 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 Income-tax Act. We will, therefore, have to answer question No. 3 by holding that the word “otherwise” takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of a retiring partner. 22. The only other contention advanced is that Section 2(47) has not been amended and consequently even if Section 45(4) has been brought in by the amendment yet there is no transfer. In our opinion, that would not be the correct position. Firstly, the definition of transfer itself is inclusive. Before the introduction of Sub-section (4), there was Clause (ii) of Section 47 which read as under : “any distribution of capital assets on the dissolution of a firm, body of individuals or other association of persons.” 23. Considering this clause as earlier contained in Section 47, it meant that the distribution of capital assets on the dissolution of a firm, etc., were not regarded as “transfer”. The Finance Act, 1987, with effect from April 1, 1988, omitted this clause, the effect of which is that distribution of capital assets on the dissolution of a firm would henceforth be regarded as “transfer”. Therefore, instead of amending Section 2(47), the amendment was carried out by the Finance Act, 1987, by omitting Section 47(ii), the result of which is that distribution of capital assets on the dissolution of a firm would be regarded as “transfer”. Therefore, the contention that it would not amount to a transfer has to be rejected. It is now clear that when the asset is transferred to a partner, that falls within the expression “otherwise” and the rights of the other partners in that asset of the partnership are extinguished. That was also the position earlier but considering that on retirement the partner only got his share, it was held that there was no extinguishment of right. Considering the amendment, there is clearly a transfer and if, there be a transfer, it would be subject to capital gains tax. 24. Considering the answers to questions Nos. 2 and 3, the orders of the Income-tax Appellate Tribunal allowing the assessee’s appeal must be set aside and the order of assessment has to be restored. Question No. 5 has to be answered accordingly. 25. Both the appeals are accordingly allowed. In the circumstances of the case each party to bear their own costs.