

Amit Kumar Choudhury, Kolkata vs Dcit, Cir-6, Kolkata, Kolkata on 19 February, 2018

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ITA No. 1357/KOL/2015
Assessment Year: 2009-20

IN THE INCOME TAX APPELLATE TRIBUNAL,
KOLKATA 'A' BENCH, KOLKATA

Before Shri P.M. Jagtap, Accountant Member and
Shri S.S.Viswanethra Ravi, Judicial Member

I.T.A. No. 1357/KOL./2015
Assessment year: 2009-2010

Amit Kumar Choudhury,.....Ap
P-205, Parnas hree Pally,
Kolkata-700 060
[PAN: ACTPC 0299A]

-Vs.-

Deputy Commissioner of Income Tax,.....Respondent
Circle-26, Kolkata,
Aayakar Bhawan (Dakshin),
2, Gariahat Road (South),
Kolkata-700 068

Appearances by:

Shri A.K. Gupta, FCA, for the assessee

Shri Sallong Yaden, Addl. CIT, D.R., for the Department

Date of concluding the hearing : December 01, 2017

Date of pronouncing the order : February 19, 2018

O R D E R

Per Shri P.M. Jagtap, Accountant Member :

This appeal filed by the assessee is directed against the order of Id. Commissioner of Income Tax (Appeals)-7, Kolkata dated 03.09.2015 and the solitary issue raised therein relates to the addition of Rs.33,35,781/- made by the Assessing Officer to the total income of the assessee on account of goodwill, which is enhanced by the Id. CIT(Appeals) to Rs.44,25,000/-.

2. The assessee in the present case is an individual, who was a partner in the partnership firm of M/s. Process Chemicals Co. with other partner being Shri Ranjit Mukherjee having profit share of 50% each. The said partnership firm was reconstituted on 01.12.2008 by inducting two new partners Shri Piyush Chakraborty and Shri Chandralekha Chakraborty.

Assessment Year: 2009-2010 After the reconstitution, the profit sharing ratio of the erstwhile two partners including the assessee was reduced to 5% from 50% with the profit sharing ratio of new partners being 60% and 30% in case of Shri Piyush Chakraborty and Shri Chandralekha Chakraborty. Thereafter the assessee retired from the partnership firm of M/s. Process Chemicals Co. from 01.04.2009. Before his retirement, he received a sum of Rs.81,81,158/- during the period 01.12.2008 to 30.03.2009 from the partnership firm as against the capital balance amount of Rs.40,02,377/- as on March 31, 2008. The assessee thus had received a sum of Rs.41,78,781/- in excess of his capital account balance and since the same was not declared by the assessee in his return of income filed originally on 20.09.2009, the Assessing Officer was of the view that there was escapement of income of the assessee from the assessment to that extent. He accordingly issued a notice under section 148 on 23.03.2012, in reply to which a letter was filed by the assessee on 19.04.2012 requesting the Assessing Officer to treat the return originally filed by it on 29.09.2009, as the return filed in response to the notice under section 148. The assessee also raised objections to the reopening of the assessment vide letter dated 09.05.2012, but overruling the same, the Assessing Officer proceeded to complete the assessment under section 147/143(3) vide an order dated 05.12.2012. In the assessment so completed, the Assessing Officer rejected the claim of the assessee that the excess amount received by him on his retirement from the partnership firm of M/s. Process Chemicals Co. was towards his share of goodwill and the cost of acquisition of the same being nil, no capital gain could be charged. In this regard, the Assessing Officer relied on the amendment made in section 55(2)(a) of the Act providing that the cost of acquisition of the self-generated assets like goodwill should be taken at nil. The Assessing Officer also found that the actual amount received by the assessee on his retirement from the partnership firm of M/s. Process Chemicals Co. in excess of his capital account balance as on 31.03.2008 as well as further credits made on account of partners' salary, interest on capital, commission and share of profit in the year under consideration was Assessment Year: 2009-2010 actually Rs.33,35,781/-. He accordingly added the said excess amount to the total income of the assessee in the assessment completed under section 147/143(3) of the Act vide an order dated 05.12.2012.

3. Against the order passed by the Assessing Officer under section 147/143(3), an appeal was preferred by the assessee before the Id. CIT(Appeals) and keeping in view the fact that a sum of Rs.44,25,000/- was credited to the capital account of the assessee in the books of the partnership firm of M/s. Process Chemicals Co. as his share of goodwill in the year under consideration, the Id. CIT(Appeals) issued show-cause notice requiring the assessee to explain as to why the addition of Rs.33,35,781/- made by the Assessing Officer to his total income should not be enhanced to Rs.45,25,000/- being the credit in his capital account on account of creation of goodwill. In reply, it was submitted by the assessee that the creation of goodwill in the books of account of the partnership firm could not be added as capital gain as there was no transfer so as to bring the amount in question to tax under section 45 of the Act. It was submitted that the amendment made in section 55(2)(a) and relied upon by the Assessing Officer was to bring to tax the capital gain on transfer of goodwill only and there being no transfer of goodwill on the retirement of the assessee from the partnership firm of M/s. Process Chemicals Co., no capital gain tax could be charged on notional basis since there was only a creation of goodwill in the books with no transfer taking place. Reliance in support of this contention was placed on behalf of the assessee on the decision of the Hon'ble Karnataka High Court in the case of CIT -vs.- Karnataka Agro (ITA No. 594 of 2013 dated

29.06.2014), wherein the partnership firm had credited self-generated assets in the form of goodwill of business to the extent of Rs.7,69,28,000/- and had transferred the same to the current account of four partners proportionately consequent to the reconstitution of the firm. The Assessing Officer brought the goodwill so created to tax under the head "long-term capital gain" and when the matter reached to the Hon'ble High Court, the Hon'ble Calcutta High Court held that when the Assessment Year: 2009-2010 goodwill was created and credited to the four partners in their profit sharing ratio in the books of the partnership firm and two of the four partners had retired, the goodwill created continued to be with the partnership firm and no portion of the same was transferred to the retiring partners. It was held that when there was no transfer of capital asset, section 45(4) was not attracted. It was also held by the Hon'ble Karnataka High Court that the partnership firm did not transfer any right in the capital asset much less the goodwill in favour of the retiring partners nor the retiring partners acquired any right in the property as no property was transferred in their favour. It was contended on behalf of the assessee before the Id. CIT(Appeals) that on the valuation of the goodwill, the goodwill was treated to be an asset of the partnership firm and the same continued to be an asset of the firm even after his retirement. It was argued that the creation of goodwill in the books of the partnership firm and corresponding credit in the partners capital account thus could not give rise to any capital gain chargeable to tax as there was no transfer of goodwill.

4. The Id. CIT(Appeals) did not find merit in the submissions made by the assessee and proceeded to hold that the amount of Rs.44,25,000/- credited to the capital account of the assessee-firm on account of goodwill was chargeable to tax in his hands as short-term capital gain for the following reasons given in his impugned order:-

"I have carefully examined the explanation of the appellant. As per the information furnished by the appellant and the account copy, an amount of Rs.44,25,000 / - was credited to the appellant's capital account under the head goodwill. Both the existing partners i.e. the appellant and Shri Puranjit Mukherjee appointed M/s Ray and Ray, Chartered Accountants for valuation of Goodwill as on 01/04/2008. The valuers have submitted their report on 27/10/2008 estimating the value at Rs.88,50,000/- and necessary entries have been passed debiting the goodwill and crediting the partners' capital account @ Rs.44,25,000/- each on 27/10/2008/-. On 1st December 2008 Partnership reconstituted with new partners and appellant along with Mr. Puranjit Mukherjee relinquished their shares to the extent of 45% each in favour of new partners. Immediately from 1 s t December 2008 the appellant Assessment Year: 2009-2010 started withdrawing the amounts from his capital account and by 30/03/2009 the appellant has withdrawn Rs.81.81 lacs including the goodwill and got retired from the firm with effect from 01/04/2009. These entire transactions clearly show that the partners intended to retire and for that purpose, the goodwill was valued and credited to the Partners' Capital account and accordingly amounts were withdrawn from the capital accounts. Therefore, the excess payments made to the partners can be regarded as the payments for relinquishing or assigning their rights in the partnership firm. And now the issue is whether the payment on account of goodwill is taxable in the hands of the Retiring Partner or not?

Section 55 of the Income Tax has been amended with effect from 01/04/1988 with an intention to bring the transfer of goodwill and the cost of acquisition will be 'nil'. The Authorised Representative(A/R) of the appellant has strongly objected for taxing the goodwill in the hands of the retiring partner. He opined that creation of goodwill cannot be treated as transfer and cannot be taxed under section 45. He argued that the asset goodwill is continued to be the asset of the firm and it has not been transferred to the appellant. No title has been transferred to the appellant. He opined that Section 45(4) is applicable only in case of dissolution of the firm but not on retirement. He also relied on Finance Act and argued that no capital gains tax can be charged on a notional basis where it was only created in the books and no actual transfer took place. The Authorized Representative (AIR) relied on Hon'ble Supreme Court .Judgement in the case of CIT Vs. Mohanbhai Pamabhai 225 ITR 221 and Hon'ble Karnataka High Court Judgement in the case of CIT Vs. Dynamic Enterprises 359 ITR 83 Full Bench and also CIT Vs. Karnataka Agro Chemicals.

I have gone through the judgement relied upon by the Ld. Authorized Representative in the case of Mohanbhai Parnabhai of Hon'ble Supreme Court and it was delivered on February 12, 1987 i.e. before amendment to section 55 of Income Tax Act. Therefore, Hon'ble Supreme Court Judgement is not helpful in the assessee's case. In the case of Karnataka High Court Judgement in the case of Dynamic Enterprises was delivered in connection with the case of the firm but not in the case of a partner. In para No.32 Honourable High court held that:

In so far as the substantial question of Law whether the retiring partner would be liable to pay capital gains tax is concerned, the said question does not arise for consideration in the appeal as the only question which arose for Assessment Year: 2009-2010 consideration was whether firm is liable to pay capital gains tax. Therefore the said question of law is not answered.

In view of the above the Judgment of Hon'ble High court is also not helpful to the appellant. Ld. Authorized Representative also relied on Hon'ble Karnataka High court judgement in the case of C.I.T vs Karnataka Agro Chemicals but this judgement also cannot be applied because the Hon 'ble High court delivered the judgement in the case of the firm but not in the case of partner.

The issue whether the goodwill is taxable or not in the hands of the partner was examined by the Hon'ble Income Tax Appellate Tribunal Hyderabad Bench in the case of Smt. Girija Reddy, P. Vs. Income Tax Officer, Ward-6(2) and delivered the decision in ITA No.297/Hyd/2012 Assessment Year 2008-09 after considering the Hon'ble Supreme Court judgement in the case of CIT vs. Mohanbhai Pamabhai, Hon'ble Supreme Court judgement in the case of CIT vs. R. Lingmallu Raghukumar (2001), and various other judgements and held as under:

Held: 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.

In this case an amount of Rs.44,25,000/- was credited to the appellant's capital account in the name of goodwill. The above amount was also withdrawn by the appellant from his capital account. This amount was nothing but the payment to retiring partner in consideration of assigning or relinquishing his share or right in the partnership and its assets in favour of continuing partners and accordingly taxable as capital gains in the hands of the appellant as held by Hon'ble ITAT, Hyd Bench, in the case law cited Supra. Accordingly I hold that the amount of goodwill credited to the appellant's capital account amounting to Rs.44,25,000/- should be taxed as short Term capital gains. I direct the Assessing officer accordingly".

Assessment Year: 2009-2010 Aggrieved by the order of the Id. CIT(Appeals), the assessee has preferred this appeal before the Tribunal.

5. We have heard the arguments of both the sides and also perused the relevant material available on record. It is observed that the goodwill of the partnership firm of M/s. Process Chemicals Co. was created during the year under consideration on the basis of valuation report dated 27.10.2008 and the same was credited to the capital account of the assessee to the extent of Rs.44,25,000/- in the ratio of his share of profit at 50%. Thereafter the partnership firm of M/s. Process Chemicals Co. was reconstituted on 01.12.2008 with two new partners joining the firm and the assessee finally retired as a partner from the said firm w.e.f. 1st April, 2009. Meanwhile the assessee during the period from 01.12.2008 to 31.03.2009 withdrew the entire amount of his capital in the partnership firm of M/s. Process Chemicals Co. including the amount of goodwill. The amount of goodwill so withdrawn from the partnership firm on his retirement was claimed to be not chargeable to tax as capital gain by the assessee on the ground that the goodwill created in the books of the partnership firm continued to remain with the said partnership firm and there was no transfer of goodwill. In support of this claim, the assessee relied on the decision of the Hon'ble Karnataka High Court in the case of Karnataka Agro as well as CBDT Circular No. 495 dated 22.09.1987 explaining the legislative intention behind the amendment made in section 55 by the Finance Act, 1987. The Id. CIT(Appeals), however, distinguished the decision of the Hon'ble Karnataka High Court in the case of Karnataka Agro (supra) on the basis that the said decision was rendered in the case of partnership firm and not in the case of the partner. As submitted by the Id. counsel for the assessee, even though the said decision was rendered by the Hon'ble Karnataka High Court in the case of partnership firm, the provisions of section 45(4) were held to be not attracted on the ground that there was no transfer of

any right in the capital asset much less the goodwill by the partnership firm in favour of the retiring partners. A perusal of the impugned order of the Id.

Assessment Year: 2009-2010 CIT(Appeals) shows that he has mainly relied on the decision of the Hyderabad Bench of this Tribunal in the case of Smt. Girija Reddy -vs.- ITO [52 SOT 113], wherein it was held that where a lumpsum payment was made to a retiring partner for consideration of assigning or relinquishing her share over assets of partnership firm in favour of continuing partners, it was a case of transfer and the assessee thus was liable to pay tax on account of capital gain. At the time of hearing before the Tribunal, the Id. counsel for the assessee has contended that the said decision of the Hyderabad Bench of this Tribunal is distinguishable on facts. He has also relied on the subsequent decision of the Hyderabad Bench of this Tribunal in the case of ACIT -vs.- N. Prasad [153 ITD 257], wherein the assessee on his retirement as a partner from the partnership firm had received a surplus amount of Rs.25,00,000/- in addition to his capital account balance. The said amount was brought to tax by the Assessing Officer in the hands of the assessee under the head "capital gains" being the amount received on transfer of goodwill. The Id. CIT(Appeals), however, deleted the addition made by the Assessing Officer on this issue and the decision of the Id. CIT(Appeals) was upheld by the Tribunal holding that there was no transfer of any asset or goodwill by the assessee on his retirement to the partnership firm. For this conclusion, the Tribunal relied on the decision of the Hon'ble Andhra Pradesh High Court in the case of Chalasani Venkateswara Rao -vs.- ITO [349 ITR 423], wherein it was held that the amount received by the assessee as full and final settlement on dissolution of firm could not give rise to any capital gain chargeable to tax as there was no transfer of any capital asset.

6. The Id. counsel for the assessee has also relied in support of the assessee's case on the issue under consideration on the decision of Coordinate Bench of this Tribunal in the case of Ajay Kumar Doshi -vs.- ACIT (ITA No. 1866/KOL/2012 dated December 11, 2015) wherein a similar issue was decided by the Tribunal vide paragraphs no. 10 to 13 of its order, which read as under:-

Assessment Year: 2009-2010 "10. We have heard the arguments of both the sides on this issue and also perused the relevant material available on record. As agreed by the Id. Representatives of both the sides, this issue involved in Ground No. 2 of the assessee's appeal is squarely covered in favour of the assessee by the various judicial pronouncements including the decisions of the Coordinate Benches of this Tribunal. In one such decision rendered in the case of Shri Amitabh Singh (ITA No. 1996/DEL/2006), Hon'ble Delhi Bench of this Tribunal decided the similar issue in favour of the assessee in the identical facts and circumstances for the following reasons given in paragraph no. 5 of its order:-

"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 as 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 u/s 45, which is the charging section. The ld. 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 ld. 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 case of Mohanbhai Pamabhai 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 Assessment Year: 2009-2010 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 ld. CIT(Appeals) that nothing was taxable in the hands of the assessee".

12. The Coordinate Bench of the Tribunal at Kolkata also had a occasion to consider the similar issue in the case of Nawshir H. Mirza, wherein the case of the assessee for exemption on account of share of goodwill received on retirement was held to be capital receipt not chargeable to tax by the Tribunal for the following reasons given in its order dated 11.01.2008 passed in ITA No. 1252/KOL/2007:-

"9. We have considered the facts of the case and rival contentions and are of the view that the order of the ld. CIT(A) needs to be upheld and does not call for any interference. In the instant case, it is not disputed that the said firms were having self generated goodwill which was valued by them during the present assessment year. There has been no transfer of such goodwill by the said firms. The firms still own and hold such goodwill and the assessee who has retired has no interest of any nature whatsoever therein. The revenue's case is primarily based on view that money received, in lieu of goodwill from the firm by the partner is casual receipt in the

nature of income which is not taxable in the hands of the firm. What the partners got at the time of the retirement including the amount credited for the goodwill of the firms is a capital receipt in their hands. The partners did not own the goodwill nor did they transfer the same. The goodwill all along remained with the firm as its asset even after the retirement of the partners. What the partners got on retirement was for the value of their interest in the firm. This view is duly supported by various decisions cited by the Id. Authorised Representative including the decision of Apex Court in the case of Sunil Siddharthbhai vs. CIT (supra).

9.1. In the instant case, the firms have not realized any amount on account of goodwill hence the question of any assessment being made in their hands does not arise. The notional valuation of the goodwill in its accounts by the firm does not result in any transfer which can attract capital gains as has also been clarified by the Board in its Circular No.495 dated September 27, 1987. Even the amendment made in Section 55(2) of the Act is of Assessment Year: 2009-2010 no help to the case of the Department in view of the clarification made by the Board.

We fail to appreciate how the amount could be assessed in the hands of the partners and that too under the head "Income from other sources. Goodwill is an intangible asset and transfer/surrender of which would attract Section 45 so that the value received would be a capital receipt and assessable if at all only under item 'E' of Section 14. It cannot be treated as a casual receipt and be subjected to tax under Section 56. The argument that even if the income cannot be chargeable u/s. 45, because of the inapplicability of the computation provided u/s. 48, it could still impose tax under the residuary head is thus unacceptable. If the income cannot be taxed u/s. 45, it cannot be taxed at all as has been held in the case of S.G. Mercantile Corporation (P) Ltd. -vs.- CIT [1972] 83 ITR 700 (SC)".

13. As the issue involved in the present case as well as all the material facts relevant thereto are similar to the cases of Shri Amitabh Singh (supra) and Nawshir H. Mirza (supra) decided by the Coordinate benches of this Tribunal, we respectfully follow the decision rendered in the said cases to hold that the amount in question received by the assessee as his share of goodwill on retirement from the firm is not chargeable to tax being capital receipt. The addition made by the Assessing Officer and confirmed by the Id. CIT(Appeals) on this issue is accordingly deleted. Ground No. 2 is accordingly allowed".

7. In our opinion, the issue involved in the present case thus is squarely covered in favour of the assessee by the various judicial pronouncements discussed above including the decision of the Coordinate Bench of this Tribunal in the case of Ajay Kumar Doshi (supra) and respectfully following the same, we delete the addition made by the Assessing Officer and enhanced by the Id. CIT(Appeals) on account of his share of goodwill received by the assessee on his retirement from the partnership firm of M/s. Process Chemicals Co.

8. In the result, the appeal of the assessee is allowed.

Order pronounced in the open Court on 19th day of February, 2018.

Sd/-
(S.S.Viswanethra Ravi)
Judicial Member

Sd/-
(P.M. Jagtap)
Accountant Member

Kolkata, the 19th day of February, 2018

Assessment Year: 2009-2010

- Copies to :
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2, Gariahat Road (South),
Kolkata-700 068
 - (3) CIT(Appeals)-7 , Kolkata,
 - (4) CIT- , Kolkata,
 - (5) The Departmental Representative
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By Order

Senior Private Secretary,
Head of Office/DDO,
Income Tax Appellate Tribunal
Kolkata Benches, Kolkata

Laha/Sr. P.S.