

**99आयकर अपीलीय अधिकरण "D" न्यायपीठ मुंबई में।**

**IN THE INCOME TAX APPELLATE TRIBUNAL "D" BENCH, MUMBAI  
BEFORE SHRI SAKTIJIT DEY, JUDICIAL MEMBER AND  
SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER**

आयकर अपील सं./I.T.A. No.1797/Mum/2012

(निर्धारण वर्ष / Assessment Year : 2007-08)

Ramesh Builders (India), 9, Dhiraj Chambers, 9, Hazarimal Somani Marg, Fort,Mumbai - 400001.	<b>बनाम/</b> v.	Income Tax Officer,12(1)(2),Aayakar Bhavan,M.K. Road, Mumbai.
स्थायी लेखा सं./PAN : AAAFR4655E		
(अपीलार्थी / <b>Appellant</b> )	..	(प्रत्यर्थी / <b>Respondent</b> )

आयकर अपील सं./I.T.A. No.1798/Mum/2012

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स्थायी लेखा सं./PAN : AAAFR8880R		
(अपीलार्थी / <b>Appellant</b> )	..	(प्रत्यर्थी / <b>Respondent</b> )

Assessee by	Shri Harsh P. Shah
Revenue by :	Dr. Mukesh Jain,DR

सुनवाई की तारीख /**Date of Hearing** : 10-05-2016

घोषणा की तारीख /**Date of Pronouncement** : 27-07-2016

**आदेश / O R D E R**

**PER RAMIT KOCHAR, Accountant Member**

These two appeals, filed by two different assesses are disposed of by this common order, of which ITA No. 1797/Mum/2012, is directed against the appellate order dated 25<sup>th</sup> January, 2012 passed by learned Commissioner of Income Tax (Appeals)- 21 Mumbai (hereinafter called "the

CIT(A)”), for the assessment year 2007-08 in the case of the assessee-Ramesh Builders(India) (PAN AAAGR4655E), the appellate proceedings before the learned CIT(A) arising from the assessment orders dated 30<sup>th</sup> December, 2009 passed by the learned Assessing Officer (hereinafter called “the AO”) u/s 143(3) of the Income Tax Act,1961 (Hereinafter called “the Act”), and the second appeal being ITA No. 1798/Mum/2012 is directed against the appellate order dated 2<sup>nd</sup> January, 2012 in the case of assessee-Ramesh Builders(PAN AAAGR8880R), the appellate proceedings before the learned CIT(A) arising from the assessment orders dated 30<sup>th</sup> December, 2009 passed by the learned Assessing Officer (hereinafter called “the AO”) u/s 143(3) of the Income Tax Act,1961 (Hereinafter called “the Act”).

**First, we shall take up assessee-M/s Ramesh Builders(India) appeal in ITA No. 1797/Mum/2012 for the assessment year 2007-08.**

2. The grounds of appeal raised by the assessee in the memo of appeal filed with the Income Tax Appellate Tribunal, Mumbai (hereinafter called “the Tribunal”) reads as under:-

“1) On the facts and in the circumstances of the case and in law, the honourable Commissioner of Income Tax (Appeals) - 21, Mumbai erred in confirming the additional of Rs. 4,521,956/- u/s. 45(4) of the Income Tax Act, 1961 (the Act) without appreciating fact that the same is not applicable in the case of retirement of the partner.

2) The honourable Commissioner of Income Tax (Appeals) - 21, Mumbai erred in the facts of the case and in law not appreciating the fact that adoption of fair market value by the Assessing Officer in the assessment order at Rs. 1,932.46 per sq. ft. in respect of unit transfer to retiring partner was not correct and the market value of Rs. 1,640/- per sq. ft. was fair and reasonable.”

3. The brief facts of the case are that assessee is a partnership firm deriving income from business and is engaged in the business of builder and

developers of property. It was observed by the A.O. that one of the partners retired vide deed of retirement dated 19<sup>th</sup> April, 2006 and he was given/allotted shops, flats etc. on the basis of book value to the extent of Rs. 1,30,19,945/-. On perusal of the P&L account of the assessee, it was observed by the AO that the assessee had shown sale consideration out of transfer of above shops/flats to the retiring partner only at Rs. 1,14,49,805/- and thus there is a difference on sale cost and book value at Rs. 15,70,140/-. The assessee was show caused as to why the sale consideration of these flats were not offered as per the prevailing market value. As per the sale summary, it was also observed by the AO that the assessee did not show sale consideration of unit no 02 and 09 in the project 'Hermes Attrium' and the same was also not appearing in the closing stock.

The assessee replied that as per the terms of the said retirement deed, the retiring partner was given the following units in the 'Hermes Attrium' Project at the book value in terms of settlement of his account in the partnership firm i.e. the assessee on his retirement. The details of the units given are as under:-

Sr. No.	Unit No.	Built up area Sq. ft.	Book value Rupees	Rate per sq. ft.
1	02	1170	785070	671.00
2	09	1170	785070	671.00
3	511	1205	2328610	1932.46
4	512	1205	2328610	1932.46
5	601	790	1526641	1932.46
6	612	1205	2328610	1932.46
7	710	760	1468667	1932.46
8	711	760	1468667	1932.46
		Total	1,30,19,945	

The assessee was asked to submit the sales instances in the project 'Hermes Atrium' immediately before or after the transfer of units to the retiring partner on 20-04-2006. The assessee submitted that there were no sales instances in the financial year 2007, 2008 and 2009, however, there were sales of units in the previous year ending 31<sup>st</sup> March, 2006 in the 'Hermes Atrium' project for which the detailed information were submitted. From the details submitted, it was observed that the closest sale instance was in respect of Unit No. 210 sold on 1st February, 2006 and the rate per sq. ft. was at Rs. 1640/- per square feet. From the perusal of the statement, it was observed that except unit No. 02 & 09, other units have been transferred at Rs. 1932.46 per sq. ft. which is much above the prevailing market price on the date of retirement. It was the contention of the assessee that there is no need to substitute the market value in respect of units mentioned at S.No. 3 to 8 as per above statement as rate adopted for transfer to retiring partner was Rs.1932.46 per square feet , however, in respect of unit no 02 and 09 at S.no. 1 & 2 the market value may be applied at Rs. 1640/- per sq. ft. based on sale instance in February 2006 being unit no 210 and the market value of unit No. 02 & 09 would be at Rs. 38,37,600/- as against the book value of Rs. 15,70,140/- and the difference of Rs. 22,67,460/- may be added to the income of the assessee was the contention of the assessee without prejudice basis. The A.O. considered the submission of the assessee and held that the assessee's contention to adopt the value at the rate of Rs. 1640/- per square feet cannot be accepted as the other units i.e. with respect to unit at S.No. 3 to 8 as per above statement had been transferred at the rate of Rs. 1932.46 per square feet, hence, the sale value of other units i.e. at the rate of Rs. 1932.46 per sq. ft. has to be adopted for the unit at S.No. 1 & 2 also as these units were also transferred to the retired partner. Accordingly, the market value shown at S. No. 1 & 2 of unit number 02 and 09 would be Rs. 45,21,956/- as against the book value shown at Rs. 15,70,140/- and also against the value requested by the assessee to adopt at Rs. 38,37,600/-

offered in its submissions. Since the assessee had shown the sale consideration in the P&L account at Rs. 1,14,49,805/- which was excluding the value of unit at Sl No. 1 & 2 i.e. Unit No. 2 & 9, the A.O. considered the sale value which worked out at Rs. 45,21,956/- and the same was added to the total income of the assessee keeping in view the provisions of section 45(4) of the Act vide assessment orders dated 30.12.2009 passed by the AO u/s 143(3) of the Act .

4. Aggrieved by the assessment order dated 30.12.2009 passed by the A.O. u/s. 143(3) of the Act, the assessee filed its first appeal before the learned CIT(A).

5. Before the learned CIT(A), the assessee submitted that the assessee firm had five partners which were family members. One of the partners retired from the partnership and remaining four partners continued the business with their revised rate of profit. It was submitted that the family members were partners and as per family arrangement and settlement, Shri Mathuradas N. Thakkar retired from the partnership firm to avoid litigation and to buy peace of family. The shops at unit no. 2 and 9 were given/allotted to the retiring partner at book value. The A.O. was of the view that the firm should have transferred the units to the retiring partner at the market rate of Rs.1932.46 per sq. ft. totaling to Rs.45,21,956/- which was added to the income of the assessee vide assessment orders dated 30-12-2009 passed u/s. 143(3) of the Act. The assessee submitted that the A.O. ought to have added Rs.29,51,816/- in place of Rs. 45,21,962/- being the difference between the Rs. 45,21,962/- minus the book value of Rs. 15,70,416/- . It was also submitted that the A.O. should have taken Rs. 1640/- per sq. ft. as fair and reasonable rate of the units transferred to the partner. The assessee also submitted that that the units were transferred/allotted to the retiring partner as per terms of family settlement and arrangement and partner's capital

account was adjusted and/or settled and accordingly the provisions of Section 45(4) of the Act were not applicable. The assessee relied on the decision of ITAT Chennai Bench in the case of (2009) 30 DTR 75, Tribunal decision reported in 126 ITD 131, DCIT v. G. K. Enterprises (2003) 79 TTJ (Mad) 82, Kay Arr Enterprises (2006) 99 ITJ (Chennai), CIT v. Kunnamkulam Mill Board 257 ITR 544 (Kerala) and other decisions and submitted that it was not a case of dissolution of firm but only a reconstitution of firm on account of retirement of one of the partners and therefore, provisions of sec.45(4) were not applicable.

The ld. CIT(A) considered the submissions and the facts of the case. The learned CIT(A) observed that during the year one of partners had retired from the partnership firm. The retiring partner was given/allotted 8 units in the project. These units were transferred to the partner at the book value. The book value of 6 units transferred to partner was at the rate of Rs.1932.46 per sq. ft. whereas the book value of other 2 units was at the rate of Rs.671.00 per sq. ft. while the A.O. held that the other 2 units should have also been transferred to the retiring partner at the rate of market value i.e. @ Rs. 1932.46 per sq. ft. and made addition of Rs.45,21,956/- in the total sales of the assessee and consequently to the income of the assessee. The ld. CIT(A) held that the assessee has failed to explain as to how the book value rate of Rs.671/- per sq. ft. was the correct rate for transferring the 2 units to the retiring partner. The learned CIT(A) observed that the assessee argued that the rates of units transferred to the retiring partner should have been taken at Rs. 1640/- per sq. ft. on the basis of sale instance of unit sold on 01.02.2006 @ Rs.1640 per sq. ft , instead of Rs.1932.46 per sq. ft. adopted by A.O.. The learned CIT(A) held that the assessee's argument is not acceptable whereby the learned CIT(A) upheld the action of the A.O. vide appellate orders dated 25-01-2012 . The ld. CIT(A) referred to the Section 45(4) of the Act whereby it was stipulated that the profits or gains arising from the transfer of

a capital asset by way of distribution of capital asset on the dissolution of a firm shall be chargeable to tax as income of the firm. In this case only one partner retired from the partnership and the remaining partners continued to be the partners of the firm with revised profit ratio. As per decision relied upon by the assessee, retirement of a single partner does not amount to dissolution of firm and therefore, provisions of Section 45(4) of the Act were not applicable. The assessee's argument of family settlement/arrangement is also rejected by the Id. CIT(A) since it was a case of distribution of assets of the firm and not distribution of the family corpus. Thus the A.O.'s action was upheld by the Id. CIT(A) vide appellate orders dated 25-10-2012. With respect to the contention of the assessee that the book value of Rs.15,70,140/- had already been included in the total sales of the firm and therefore, the A.O. should have made addition of only differential amount of Rs.29,51,816/-, the Id. CIT(A) directed the A.O. to verify the assessee's contention and then decide the same on merits whereby if the book value of Rs.15,70,140/- is found to be credited in the total sales in the P&L account, the addition of only differential amount should only be made by the A.O. and if the book value of Rs.15,70,140/- is found not credited in the P&L account, the addition of Rs.45,21,956/- will be sustained, vide learned CIT(A) appellate orders dated 25-01-2012.

6. Aggrieved by the appellate order dated 25-01-2012 of the learned CIT(A), the assessee filed second appeal before the Tribunal.

7. The Id. Counsel for the assessee submitted that there was a reconstitution of the firm. One of the partners retired while rest of the partners continued the business with their revised rate of profit sharing ratio. There were eight units in the building project 'Hermes Atrium' and these units were transferred to the retiring partner at book value at the time of retirement from the partnership firm. The Id. Counsel submitted that the

A.O. applied provisions of section 45(4) of the Act whereby the value of two units being unit no. 02 and 09 transferred was taken at the book value of Rs. 671.00 per sq. ft. at Sr. No. 1 & 2 as per chart in preceding para's whereas the book value taken for other six units transferred to the partner was at Rs. 1932.46 per sq. ft. . It was submitted that it is case of retirement of one of the family members. It is a case of family arrangement and settlement to avoid litigation and to buy peace in the family, hence, section 45(4) of the Act cannot be applied. The property should be valued at book value.

8. The ld. D.R., on the other hand, submitted that the assessee has adopted Rs. 1932.46 per sq. ft. which is the market value for 6 units transferred to the partner whereas the book value of other two units was taken at the rate of Rs. 671.00 per sq. ft. which was without any basis. It was submitted that the AO rightly adopted rate of Rs.1932.46 per square feet also for transfer of two units being unit no 02 and 09 at S.no 1 and 2 in the chart as no distinguishing features are brought on record by the assessee to distinguish the reasons for adopting lower value. The ld DR also submitted that rate of Rs.1640 per square feet also cannot be adopted as the said unit was sold prior to the relevant previous year. There was a transfer of property to the retiring partner which should be taxed at fair market value as per mandate of Section 45(4) of the Act.

9. We have considered the rival contentions and also perused the material available on record. We have observed that the assessee is partnership firm. One of the partners retired from the partnership firm and the said partner was given 8 units of property in the project 'Hermes Attrium' at the time of retirement. Provisions of section 45(4) of the Act are clearly applicable in this case which stipulates as under:

*E.—Capital gains*

**Capital gains.**

45.(1) \*\*\*\*

(1A) \*\*\*\*

(2)\*\*\*\*

(2A)\*\*\*\*

(3)\*\*\*\*

(4) 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.]

(5)\*\*\*\*

(6)\*\*\*\*”

Hon’ble Bombay High Court in the case of CIT v. A.N.Naik Associates (2004) 265 ITR 346(Bom ) has held as under:

*“ 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 chargeable. 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 :*

*"(4) 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) alone with sub-section (3) were introduced by the Finance Act, 1987, with effect from April 1, 1988. From a reading of the above sub-section 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 partner-ship firm by agreement under section 40 of the Indian Partnership Act. The Revenue has firstly placed reliance in the case of Erich F.D. Mehta v. Minoo F.D. Mehta AIR 1971 SC 1653. 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 AIR 1985 SC 608, 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 issue 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 & Co. Ltd. v. CTO [1985] 154 ITR 148<sup>1</sup>. The Apex Court therein had observed as under :*

*". . . We must recognize 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 Ltd., In re [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." (p. 160)*

**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 AIR 1966 SC 323, 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<sup>1</sup>. 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<sup>1</sup>, 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. R. Lingmallu Raghukumar [2001] 247 ITR 801 (SC), in respect of an order of the Andhra Pradesh High Court in 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 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 [1991] 189 ITR 285 (SC). 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 Sakthi Trading Co.v. CIT [2001] 250 ITR 871<sup>2</sup> (SC), 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/Kartikeya V. Sarabhai v. CIT [1985] 156 ITR 509 (SC), 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 and 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* [2002] [256 ITR 540](#) (Mad.), 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. Kunnankulam Mill Board* [2002] [257 ITR 544](#) (Ker.) 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 [1999] 236 ITR 515 (SC). 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 & Sons v. CGT [1997] 224 ITR 431 (Kar.). 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 there from 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 & Sons v. CGT [2001] [247 ITR 588](#) upholding the judgment of the Karnataka High Court. The Apex Court observed as under :*

*"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 very 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...." (p. 591)*

*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.*

**19.** *Before proceeding to further examine the matter, we may consider the judgment in N. Bagavathy Ammal v. CIT [2003] [259 ITR 678](#) (SC). 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.*

**20.** *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.'s case (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 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 subsection (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*

*Amendment 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's case (supra) 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 in 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 :*

*"(ii) 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 question 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.”*

We have observed that the issue with respect to taxability of the amount received by the partner on retirement from the partnership firm for extinguishment of his rights in the partnership firm in favour of the continuing partners has been decided by the Hon'ble Bombay High Court in the case of CIT v. Shri Rajnish Maniklal Bhandari, IT Appeal No. 2058 of 2012, vide judgment dated 9th March, 2013 and in the case of CIT v. Mr. Riyaz A. Sheikh in I.T. Appeal No. 1969 of 2011 vide judgment dated 26th February, 2013, whereby the Hon'ble Bombay High Court has held that the said amount received by partner on retirement from the partnership firm is not taxable in the hands of the partner. The Hon'ble Bombay High Court in the case of Riyaz A Sheikh reported in (2014) 41 taxmann.com 455(Bom.) held as under :

*"2. We find that by the impugned order, the Tribunal while holding that amounts received by a partner on his retirement from partnership firm are exempt from capital gains tax relied upon the decision of this Court in the matter of [Prashant S. Joshi v. ITO](#) [2010] 324 ITR 154/189 Taxman 1 (Bom). Counsel for the revenue is unable to point out as to how the decision in the matter of [Prashant S. Joshi](#) (supra) inter alia holding that no capital gains are payable by an erstwhile partner on amounts received on retirement would not be applicable to the present case. The only submission on behalf of the revenue is that there was an earlier decision of this Court in the matter of [N.A. Modi v. CIT](#) [1986] 162 ITR 420/24 Taxman 219 (Bom.) and it has not been considered in the decision rendered in the matter of [Prashant S. Johsi](#) (supra).*

*3. In the impugned order, the Tribunal does refer to the this Court in the matter of [N.A. Modi](#) (supra) and states that it follows the decision of this Court in the matter of [CIT v. Tribhuvandas G. Patel](#) [1978] 115 ITR 95 (Bom.) and the same has been reversed by the Apex Court in [Tribhuvandas G. Patel v. CIT](#) [1999]*

*236 ITR 515. This Court in the matter of Prashant S. Joshi (supra) has also referred to the decision of Tribuvandas G. Patel (supra) rendered by this Court and its reversal by the Apex Court. Moreover, the decision of this Court in the case of Prashant S. Joshi (supra) placed reliance upon the decision of the Supreme Court in the case of CIT v. R. Lingamallu Rajkumar [2001] 247 ITR 801/[2002] 124 Taxman 127 wherein it has been held that amounts received on retirement by a partner is not subject to capital gains tax. In the above circumstances, we see no reason to entertain the proposed question of law."*

The issue of taxability of amount received by the partner on retirement from the partnership firm for extinguishment of his rights in the partnership firm in favour of the continuing partners was also discussed by the Hon'ble Bombay High Court in the case of [Prashant S Joshi v. ITO](#) reported in (2010) 324 ITR 154(Bom.) after considering the omission of [Section 47\(ii\)](#) from the statute w.e.f 01-04-1988 as reproduced here-under:

*"12. The only reason that has been recorded by the Assessing Officer is that the Commissioner of Income-tax (Appeals) by his order dated 17-9-2008, in the case of the partnership firm for assessment year 2005-06 allowed a claim for treating the payment of Rs. 1 crore to the two retiring partners as revenue expenditure. Since the assessee claimed the payment to be exempt by treating it as a capital receipt, it is stated that there was reason to believe that the receipts under the deed of retirement had escaped assessment within the meaning of section 147.*

*13. During the subsistence of a partnership, a partner does not possess an interest in specie in any particular asset of the partnership. During the subsistence of a partnership, a partner has a right to obtain a share in profits. On a dissolution of a partnership or upon retirement, a partner is entitled to a valuation of his share in the net assets of the partnership which remain after*

*meeting the debts and liabilities. An amount paid to a partner upon retirement, after taking accounts and upon deduction of liabilities does not involve an element of transfer within the meaning of section 2(47). Chief Justice P.N. Bhagwati (as the learned Judge then was) speaking for a Division Bench of the Gujarat High Court in [CIT v. Mohanbhai Pamabhai](#) [1973] 91 ITR 393 dealt with the issue in the following observations:--*

*"...When, therefore, a partner retires from a partnership and the amount of his share in the net partnership assets after deduction of liabilities and prior charges is determined on taking accounts on the footing of notional sale of the partnership assets and given to him, what he receives is his share in the partnership and not any consideration for transfer of his interest in the partnership to the continuing partners. His share in the partnership is worked out by taking accounts in the manner prescribed by the relevant provisions of the partnership law and it is this and this only, namely, his share in the partnership which he receives in terms of money. There is in this transaction no element of transfer of interest in the partnership assets by the retiring partner to the continuing partners : vide also the recent decision of the Supreme Court in [CIT v. Bankey Lal Vaidya](#). It is true that [section 2\(47\)](#) defines "transfer" in relation to a capital asset and this definition gives an artificially extended meaning to the term "transfer" by including within its scope and ambit two kinds of transactions which would not ordinarily constitute "transfer" in the accepted connotation of that word, namely, relinquishment of the capital asset and extinguishment of any rights in it. But even in this artificially extended sense, there is no transfer of interest in the partnership assets involved when a partner retires from the partnership."*

*The Gujarat High Court held that there is, in such a situation, no transfer of interest in the assets of the partnership within the meaning of section 2(47). When a partner retires from a partnership, what the partner receives is his*

*share in the partnership which is worked out by taking accounts and this does not amount to a consideration for the transfer of his interest to the continuing partners. The rationale for this is explained as follows in the judgment of the Gujarat High Court :-*

*"...What the retiring partner is entitled to get is not merely a share in the partnership assets; he has also to bear his share of the debts and liabilities and it is only his share in the net partnership assets after satisfying the debts and liabilities that he is entitled to get on retirement. The debts and liabilities have to be deducted from the value of the partnership assets and it is only in the surplus that the retiring partner is entitled to claim a share. It is, therefore, not possible to predicate that a particular amount is received by the retiring partner in respect of his share in a particular partnership asset or that a particular amount represents consideration received by the retiring partner for extinguishment of his interest in a particular asset."*

14. *The appeal against the judgment of the Gujarat High Court was dismissed by a Bench of three learned Judges of the Supreme Court in Addl. CIT v. Mohanbhai Pamabhai [1987] 165 ITR 166 .*

*The Supreme Court relied upon its judgment in Sunil Siddharthbhai v. CIT [1985] 156 ITR 509. The Supreme Court reiterated the same principle by relying upon the judgment in Addanki Narayanappa v. Bhaskara Krishnappa AIR 1966 SC 1300. The Supreme Court held that what is envisaged on the retirement of a partner is merely his right to realise his interest and to receive its value. What is realised is the interest which the partner enjoys in the assets during the subsistence of the partnership by virtue of his status as a partner and in terms of the partnership agreement. Consequently, what the partner gets upon dissolution or upon retirement is the realisation of a pre-existing right or interest. The Supreme Court held that there*

*was nothing strange in the law that a right or interest should exist in praesenti but its realisation or exercise should be postponed. The Supreme Court inter alia cited with approval the judgment of the Gujarat High Court in Mohanbhai Pamabhai's case (supra) and held that there is no transfer upon the retirement of a partner upon the distribution of his share in the net assets of the firm. In CIT v. R. Lingmallu Raghukumar [2001] 247 ITR 801 , the Supreme Court held, while affirming the principle laid down in Mohanbhai Pamabhai that when a partner retires from a partnership and the amount of his share in the net partnership assets after deduction of liabilities and prior charges is determined on taking accounts, there is no element of transfer of interest in the partnership assets by the retired partner to the continuing partners.*

15. At this stage, it may be noted that in *CIT v. Tribhuvandas G. Patel* [1978] 115 ITR 95 (Bom.), which was decided by a Division Bench of this Court, under a deed of partnership, the assessee retired from the partnership firm and was inter alia paid an amount of Rs. 4,77,941 as his share in the remaining assets of the firm. The Division Bench of this Court had held that the transaction would have to be regarded as amounting to a transfer within the meaning of *section 2(47)* inasmuch as the assessee had assigned, released and relinquished his share in the partnership and its assets in favour of the continuing partners. This part of the judgment was reversed in appeal by the Supreme Court in *Tribhuvandas G. Patel v. CIT* [1999] 236 ITR 515. Following the judgment of the Supreme Court in *Sunil Siddharthbhai's case (supra)*, the Supreme Court held that even when a partner retires and some amount is paid to him towards his share in the assets, it should be treated as falling under clause (ii) of *section 47*. Therefore, the question was answered in favour of the assessee and against the revenue. *Section 47(ii)* which held the field at the material time provided that nothing contained in *section 45* was applicable to certain transactions specified therein and one of the transactions specified in clause (ii) was distribution of the capital assets on a dissolution of a

*firm. Section 47(ii) was subsequently omitted by the Finance Act of 1987 with effect from 1-4-1988. Simultaneously, sub-section (4) of section 45 came to be inserted by the same Finance Act. Sub-section (4) of section 45 provides that 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. The fair market value of the assets 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 for the purpose of section 48. Ex facie sub-section (4) of section 45 deals with a situation where there is a transfer of a capital asset by way of a distribution of capital assets on the dissolution of a firm or otherwise. Evidently, on the admitted position before the Court, there is no transfer of a capital asset by way of a distribution of the capital assets, on a dissolution of the firm or otherwise in the facts of this case. What is to be noted is that even in a situation where sub-section (4) of section 45 applies, profits or gains arising from the transfer are chargeable to tax as income of the firm."*

Thus, from the above it is clear that as per Section 45(4) of the Act 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 person 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 purpose of section 48 of the Act , 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 . The assessee has transferred 8 units to the retiring partner for which book value was adopted, whereby book value of 6 units transferred to the partner was @ Rs. 1932.46 per sq. ft. and the book value of 2 units was @ Rs. 671.00 per sq. ft. . No

reasons or justification was brought on record by the assessee during the course of assessment or appellate proceedings before the authorities below as well as before us for the reason for adopting the different book value between unit no. 02 and 09 at S.no 1 and 2 of the chart and the other six units so transferred to the retiring partner albeit the said units were situated in the same building project 'Hermes Attrium'. Since no explanation whatsoever has been submitted to distinguish and justify the adoption of two differential rates within the same building project 'Hermes Attrium', we are of the considered view that the same value has to be applied for unit no. 02 and 09 at S. No. 1 & 2 of the units in the chart which were situated in the same building project 'Hermes Attrium', which were adopted for the other six units transferred in the same building project 'Hermes Attrium' to the retiring partner. We do not find any merit in the contentions of the assessee in the absence of cogent reasons and justifications to distinguish the units to adopt differential rates. Thus the book value of Rs. 1932.46 per sq. ft. which was adopted and accepted by the assessee as fair market value of six units is fully justifiable and the action of the A.O. is justified and rightly confirmed by the Id. CIT(A). The value of Rs.1640 per square feet as per sale instance of unit no. 210 in the building project 'Hermes Attrium' in February 2006 can also be not adopted as the assessee has not brought any similarity of the said unit no 210 in project 'Hermes Attrium' sold in February 2006 with the unit no 02 and 09 at S.no. 1 and 2 of the chart as well when the fair market value on the transfer of unit on 20-04-2006 are available as for the six units namely 511,512,601, 612, 710 and 711 and no distinguishing features have been brought with respect to unit no 02 and 09 vis-à-vis other six units transferred to retiring partner although all the units transferred are situated in the same building, then there is no need to adopt any other separate value for unit no 02 and 09 in the building project 'Hermes Attrium'. The primary onus was on the assessee to distinguish and justify the adoption of any other rate apart from Rs.1932.46 per square feet by bringing on record the distinguishable features in the units located in the same building to justify the adoption of lower rate of Rs.671 per square feet for unit no 02 and 09 vis-à-vis other

six units so transferred which is lower than Rs.1932.46 per square feet being book value which is agreed by the assessee for six units 511,512,601,612,710 and 711 in the same building complex to be adopted for transfer of the units to the retiring partners. We order accordingly.

10. In the result the assessee appeal in ITA no 1797/Mum/2012 for the assessment year 2007-08 is dismissed.

**Now we shall take up assessee-Ramesh Builders appeal in ITA No. 1798/Mum/2012 for the assessment year 2007-08.**

11. The grounds of appeal raised by the assessee in the memo of appeal filed with the Income Tax Appellate Tribunal, Mumbai (hereinafter called "the Tribunal") reads as under:-

“1) On the facts and in the circumstances of the case and in law, the honourable Commissioner of Income Tax (Appeals) - 21, Mumbai is not justified and erred in holding that payment of compensation of Rs. 24,035,000/- was neither allowable U/S 24 of the Income Tax Act, 1961 (the Act) nor U/S 37(1) of the Act.

2) The honourable Commissioner of Income Tax (Appeals) did not appreciate the fact that the said amount of Rs. 24,035,000/- was paid by way of compensation for release of rights in the premises and for the termination of lease agreement with view to derive economic benefits to the appellant and was incurred keeping in mind the commercial expediency and from the perspective of the prudent businessmen and accordingly the expenditure was incurred for the purpose of interest and therefore allowable U/S 37(1) of the Act.

3) On the facts and in the circumstances of the case and in law, the honourable Commissioner of Income Tax (Appeals) - 21, Mumbai erred in confirming the disallowance of Rs. 432,000/- out of interest expenses on the ground that such expenses was not incurred wholly and exclusively for the purpose of the business of the appellant.

4) On the facts and in the circumstances of the case and in law, the honourable Commissioner of Income Tax (Appeals) - 21, Mumbai erred in confirming the disallowance of Rs. 60,000/- out of professional fees.

5) On the facts and in the circumstances of the case and in law, the honourable Commissioner of Income Tax (Appeals) - 21, Mumbai erred in confirming the disallowance of Rs. 16862/-out of repairs and maintenance expenses.”

12. The brief facts of the case are that the assessee is a builder and developer of property and has undertaken project at Pune. It was observed by the AO from the P&L account that the assessee has debited an amount of Rs. 2,40,35,000/- under the head compensation for release of rights in premises. The A.O. observed that the assessee firm has given compensation of Rs. 2,40,35,000/- to M/s. Pyramid Retail & Merchandising Pvt. Ltd.(Hereinafter called “ the Pyramid”) regarding termination of the lease agreement which was entered into w.e.f. 1st April, 2001 till March 2011 with respect to the premises ‘Hermes Plazzo’ situated at 1978, Convent Street, Camp, Pune-411001. The contention of the assessee was not acceptable to the A.O. due to the reasons that rental income received by the assessee from the Pyramid has been shown as ‘income from house property’ and the assessee had availed deduction u/s 24 of the Act, hence, the said compensation expenses do not fall within the purview of Section 24 of the Act , and also that the said expenses have not been incurred for the purpose of the business of the assessee and hence not eligible for deduction u/s 37(1) of the Act. When the assessee was confronted as to how the compensation of Rs.2,40,35,000/- paid by the assessee firm to the Pyramid for termination of the lease agreement be allowed under the provisions of the Act, it was submitted by the assessee that the assessee had received additional interest free deposit of Rs. 70 lacs for a period of 12 years from the date of commencement of agreement dated 10<sup>th</sup> January, 2007 with M/s Pantaloon Retails India

Limited(hereinafter called “the Pantaloon”) whereby total interest free deposit of Rs. 120 lacs was received under the new agreement with the Pantaloon, and the deposit of Rs. 50 lacs which was received from old licensee , the Pyramid was to be refunded by 31<sup>st</sup> March, 2011 and in short the assessee firm received additional interest free deposit of Rs. 70 lacs from the Pantaloon for a longer period of time. The said new agreement with the Pantaloon was also for a longer period of time that is 9 years and further provision for renewal of agreement for additional three years aggregating to 12 years. Under the said agreement with Pantaloon, the consideration i.e. the business conducting fees was guaranteed @ 2% of net sale proceeds of Pantaloon and with a provision of increase in the minimum guaranteed conducting fees by 20% over the immediately preceding minimum guaranteed conducting fees payable at the end of every block of 3 years from the commencement date. Thus, considering the aforesaid factors the assessee firm decided to terminate the existing leave and license agreement with the Pyramid by paying the compensation of Rs. 2,40,35,000/- for their exit from the assessee’s premises to enable the assessee to use the premises for a better and more profitable purposes. Thus , the expenses were incurred keeping in view the commercial expediency and from the perspective of a prudent businessman and hence it was contended by the assessee that the same is allowable u/s 37(1) of the Act. The assessee placed reliance on the following decisions:-

- (i) Jugal Kishore Baldev Sahai v. CIT (1967) 63 ITR 228.
- (ii) Sri Venkata Satyanarayana Rice Mill Contractors Co. v. CIT (1977) 223 ITR 101.
- (iii) CIT v. Walchand & Co. (P) Ltd. (1967) 65 ITR 381
- (iv) Sasson J. David & Co. (P) Ltd. v. CIT (1979) 118 ITR 261
- (v) CIT v. Birla Cotton Spg. & Wvg.Mills (1972) 82 ITR 166
- (vi) S.A. Builders Ltd. v. CIT (2007) 288 ITR 1

The A.O. went through the submission of the assessee and distinguished the case laws relied upon by the assessee by observing as under:-

“i) In the case of Jugal Kishore Baldev Sahai v. CIT (1967) 63 ITR 228, the issue involved was that HUF had paid remuneration to its Karta and question was that whether it is allowable or not?

ii) In the case of Sri Venkata Satyanarayana Rice Mill Contractors Co. v. CIT (1977) 223 ITR 101, the issue involved was that whether payment made by the assessee to a fund which was constituted to promote public welfare and contribution to which was voluntary, but was nevertheless required from the assessee at the time the assessee sought a permit for the movement of his goods from the state would constitute expenditure incidental to the carrying on of the business of the assessee.

iii) In the case of CIT v. Walchand & Co. (P) Ltd. (1967) 65 ITR 381. The facts of the case were that the assessee company had increased remuneration of its directors and executive officers. The AO disallowed the increase in the remuneration of the directors and the Executive Officers on the ground that expenditure was not laid out wholly & exclusively for the purpose of the business of the assessee company.

iv) In the case of Sasson J. David & Co. (P) Ltd. CIT (1979) 118 ITR 261 the issue involved regarding deductibility of expenses u/s 37(1) even though there was no compelling necessity to incur such expenditure.

v) In the case of CIT v. Birla Cotton Spg. & Wvg. Mills (1972) 82 ITR 166 the issue was decided that expenditure which is incurred in opposing coercive governmental action with the object of saving taxation and safeguarding business is deductible.

vi) In the case of S.A. Builders Ltd. v. CIT (2007) 288 ITR 1 the issue decided was that if the holding company advances borrowed money to the subsidiary and the same is used by the subsidiary for some business purposes, the assessee would

ordinarily be entitled to deduction of interest on its borrowed loans.”

The A.O. observed that the assessee’s contentions cannot be accepted as these expenditure are non-recurring in-nature. The A.O. relied on the decision of Hon’ble Supreme Court in the case of Swadeshi Cotton Mills Co. Ltd. v. CIT, (1967) 63 ITR 65(SC) wherein it was held that compensation payable for breach of contract was capital expenditure. The AO held that the assessee is a firm engaged in the business of builder and developers. The expenses incurred by the assessee firm regarding the said payment of the compensation is not pertaining to the assessee's said real estate business. The compensation has been given in respect of the property from which the assessee firm is deriving income which is in the nature of income from house property. Hence, the same is not allowable expenses as it is not in connection with the business carried on by the assessee. Further, it was observed that the compensation expenses of Rs. 2,40,35,000/- does not fall under the purview of section 24 of the Act. Reliance was placed by the AO on the decision in the case of CIT v. H.G. Gupta & Sons (1984) 149 ITR 253 (Delhi) wherein it was held that deduction not specifically provided for are not admissible. The A.O. observed that as per the agreement between the assessee firm and the Pyramid , there is no clause for compensation in the event of termination of the agreement by the assessee. Thus, the compulsion and the genuineness of the assessee firm regarding payment of compensation to the Pyramid were not found satisfactory and accordingly the same was disallowed and added to the income of the assessee by the AO vide assessment orders dated 30-12-2009 passed u/s 143(3) of the Act.

13. Interest on loan and advances:- On perusal of the balance sheet of the assessee, it was observed by the AO that the assessee has taken new secured loan during the year to the tune of Rs.13,99,33,597/- from the HDFC Bank.

The assessee was asked to furnish the details of secured loan as shown in the balance sheet and utilization of the said loan fund thereof. In response, to the same, the assessee submitted that the utilization of the said bank loan fund cannot be ascertained and thereby no details were furnished in this respect. The assessee has taken loan from the HDFC Bank during the year totaling to Rs. 13,99,33,597/- and has paid interest of Rs. 20,21,919/- to the bank on the said loan amount. Since no detail was furnished in respect of utilization of the funds, it was observed from the balance sheet that during the year the assessee firm has advanced a loan of Rs. 3 crores to M/s Modi Milk & Agro Product Pvt. Ltd. However, no details were filed regarding the date on which such loans were given and also assessee has not shown any interest income on loan/advance granted to M/s Modi Milk & Agro Product Pvt. Ltd. Accordingly, interest on the advances of Rs. 3,00,00,000/- is charged proportionately which works out to be Rs.4,32,000/- and the same was added to the income of the assessee by the AO vide assessment orders dated 30-12-2009 passed u/s 143(3) of the Act.

14. Architect and Legal expenses:- The A.O. observed that the assessee had made a payment of Rs. 60,000/- towards consultation charges for legal works of Lunkad Amazon & Lunkad Hermes and above payment does not relate to assessee firm's business and has been paid for joint venture project and the same was disallowed and added to the total income of the assessee by the AO vide assessment orders dated 30-12-2009 passed u/s 143(3) of the Act.

15. Repair and Maintenance charges: It was observed by the A.O. that the assessee firm has debited an amount of Rs. 1,68,626/- under the head repairs and maintenance charges for which self generated vouchers were produced and some of the expenses were incurred in cash. 10% of the expenditure i.e. Rs. 16,862/- were disallowed and added to total income of

the assessee by the AO vide assessment orders dated 30-12-2009 passed u/s 143(3) of the Act.

16. Aggrieved by the assessment orders dated 30-12-2009 passed by the AO u/s 143(3) of the Act , the assessee filed its first appeal before the learned CIT(A) . During the appellate proceedings before the learned CIT(A), the assessee submitted that the assessee is a partnership firm carrying on the business of builders and developers of immovable properties or to exploit the immovable properties on commercial basis. The assessee explained that it had entered into a Business Conducting Agreement dated 12.03.2001 with the Pyramid in respect of building premises at Pune. The Pyramid had paid an interest free deposit of Rs.50 lacs to the assessee and as per the said agreement the amount of Rs. 76 lacs was payable per annum towards the business conducting charges which was to be increased on a year to year basis. The agreement was from 1.04.2001 to 31.03.2011 for a period of 10 years and the said Pyramid was operating a Shopping Mall at that premises and for that purpose Pyramid made necessary corrections, alterations, renovations and repairs on the said premises for conducting and operating the shopping outlets in the Shopping Mall. In the relevant previous year 2006-07, the assessee got a better offer from Pantaloon for conducting its retail Shopping Mall at the assessee's said premises. The said Pantaloon agreed to give interest free deposit of Rs.1,20,00,000/-. The term of agreement was for 9 years with renewal period of 3 years. The minimum business conducting charges receivable from the Pantaloon was decided at the rate of 2% of net sales on monthly basis with the provisions for increase by 20% at the end of every block of 3 years. Since the proposal received from the Pantaloon was commercially more lucrative and profitable for the assessee, it was decided by the assessee to enter into an agreement with Pantaloon with revised terms and conditions. For this purpose, it was necessary to terminate the existing business conducting agreement with the

existing tenant the Pyramid to get vacant possession of the said premises back from the Pyramid and to enable the assessee to enter into a fresh Business Conducting Agreement with M/s Pantaloon. Accordingly, a Supplementary Agreement dated 12.12.2006 was entered into between the assessee firm and the Pyramid and the business conducting agreement for the remaining period was terminated with effect from 8<sup>th</sup> December, 2006. For early terminating the afore-said agreement prior to its contractual maturity, the assessee firm agreed to give a lump sum compensation of Rs.2,40,00,000/- to the Pyramid on account of releasing their right under the agreement and also on account of expenses incurred by the Pyramid from time to time on account of alteration, modifications, renovation and extra work carried out by them in the said premises. Thus by entering into a fresh agreement with the Pantaloon, the assessee received additional interest free deposits of Rs.70 lacs for a period of 12 years. The Business Conducting Agreement was also for a longer period of time i.e. 9 years with further provision for renewal of agreement for 3 more years. Under the fresh Business Conducting Agreement with the Pantaloon, the Business Conducting fees was guaranteed @ 2% of net sale proceeds of Pantaloon with a provision of increase and keeping in view the commercial interest of the assessee, it was decided to terminate Business Conducting Agreement with the Pyramid even by paying a compensation of Rs.2,40,00,000/- to terminate the Business Conducting Agreement and to get back the vacant possession of the premises. Thus, the payment of compensation was made by the assessee considering the commercial expediency when seeing from the perspective of business of the assessee firm as it was in business interest of the assessee to terminate the agreement and get back vacant possession from Pyramid. Therefore, the compensation expenditure was allowable u/s 37(1) of the Act. The assessee further explained that the compensation of Rs.2,40,00,000/- was not claimed against the income from house property but after termination of lease agreement with the Pyramid, this amount was paid for getting vacant

possession of the premises for giving the same for a longer period and for earning more lease rent. The assessee in support relied on the following decisions:-

- (i) CIT v. M/ s. Auto Distributors Ltd. (1994) 210 ITR 222 Calcutta (HC)
- (ii) CIT v. S.R. Ramkrishnan (1969) 74 ITR 761 (Madras)
- (iii) CIT v. R.G.S. Industries (1990) 183 ITR 31 Gauhati (1990) 51 Taxman 467 (Gauhati)
- (iv) CIT v. S.A. Builders 288 ITR 1 (SC)
- (v) CIT v. Motor Industries Co. Ltd. (1997) 223 ITR 112 (Kerala H.C.)
- (vi) CIT v. Pioneer Engineering Syndicate (1989) 175 ITR 93 (Madras).”

The assessee submitted that since the compensation was treated as revenue receipts in the hands of recipient , the same should be treated as revenue expenses in the hands of the assessee.

The learned CIT(A) considered the contentions of the assessee whereby it was observed that the assessee was engaged in the business of builders & developers of the property. The assessee was also owning properties on which rental income was received. The assessee was owning Pune premises and vide agreement dated 12<sup>th</sup> March, 2001, the Pune premises was given on Leave & License basis to the Pyramid , from which the assessee derived income from house property of Rs.59,86,464/- which is offered for taxation by the assessee under the head ‘Income from house property’ , whereas all other receipts were shown as income under the head ‘income from business or

profession'. The Pyramid renovated the premises by incurring various expenditure for the purpose of running a Shopping Mall Centre thereon. During the year, the assessee got a better offer from the Pantaloon to take this Pune property on Leave & License basis for running their Mall whereby M/s Pantaloon offered more rental income besides interest free deposit of Rs.1.20 crores. The assessee entered into an agreement with the Pyramid for getting this property vacated from them and for this purpose, the assessee paid compensation of Rs.2,40,35,000/- to the Pyramid for vacating the premises. The assessee was deriving rental income and the same was being offered to tax as income under the head 'income from house property'. This payment of compensation of Rs.2,40,35,000/- was pertaining to this Pune property itself and as per the provisions of section 23 & 24 of the Act the deductions allowable against the income under the head 'income from house property' are municipal taxes if paid during the year, 30% deduction of annual value and interest expenditure if the property was acquired with the help of borrowed funds. The learned CIT(A) held that u/s 23 & 24 of the Act, no other deduction is allowable under the head 'income from house property'. Thus, the learned CIT(A) held that no deduction of this expenditure of Rs.2,40,35,000/- was allowable under the head 'income from house property'. This payment of compensation of Rs.2,40,35,000/- was not made by the assessee for earning the existing rental income but was paid for earning extra rental income. In this case this payment of compensation was made by the assessee for acquiring a new/extra source of income. As such payment of compensation was capital expenditure in nature which was not a recurring expenditure but the assessee derived a benefit of enduring nature, therefore this expenditure was not a revenue expenditure but was capital in nature. Hence, it was held that whether this is revenue or capital expenditure, this expenditure was not at all allowable under the head 'income from house property'. It was further held by learned CIT(A) that this expenditure of payment of compensation of Rs.2,40,35,000/- made by the assessee could

not be allowed under the head Business Income as the payments was not made wholly and exclusively for the purpose of business. It was held by the learned CIT(A) that this expenditure could not be held as capital expenditure pertaining to the existing business income/receipts. The judicial precedents relied upon by the assessee are not relevant and hence this ground was dismissed by the Id. CIT(A) by holding that this expenditure was neither allowable u/s 23/24 of the Act nor allowable u/s 37(1) of the Act vide learned CIT(A) appellate orders dated 02-01-2012.

17. With regard to the issue of interest on loan and advances, the assessee contended before the Id. CIT(A) that it had received loan, some of which was interest bearing and some of which was interest free. The assessee has also received interest free deposit from the party and had capital balance of partners which was utilized in the business. Under the circumstances, the assessee had utilized the mixed funds and therefore, it was not possible for the assessee to submit the exact nexus of utilization of loan amount availed from HDFC Bank Ltd. The assessee relied on the decision of Hon'ble Bombay High Court in the case of CIT v. Reliance Utilities and Powers Ltd. 313 ITR 340(Bom. HC), and submitted that if two types of funds are available i.e. interest bearing and interest free funds then presumption would arise that interest free funds had been generated for making investment. The Id. CIT(A) considered the submission of the assessee and observed that the assessee had obtained interest bearing loan of Rs.13.99 crore from HDFC Bank. The assessee had advanced interest free loan of Rs.3 crores to M/s Modi Milk & Agro Product Pvt. Ltd. The Id. CIT (A) observed from the balance sheet Schedule -G that opening balance or loans and advances given was at Rs.3.35 crore whereas closing balance was Rs.6.16 crores. The assessee has not furnished all the details of date and purpose of advancing interest free loan of Rs. 300 lacs to M/s. Modi Milk & Agro Product Pvt. Ltd. during the assessment as well as appellate proceedings. However from the opening and

closing balance of loan and advances given, it appears that the interest free loan of Rs. 3 crores was advanced by the assessee during the year itself and the AO has correctly held that the interest bearing loans obtained was utilized for non business purpose of advancing interest free loans. The assessee has not explained any commercial expediency for advancing interest free loans of Rs. 300 lacs to the said party M/s Modi Milk & Agro Product Pvt. Ltd. Under these circumstances, the AO was justified in holding that the proportionate interest expenditure of Rs. 4,32,000/- was not incurred wholly and exclusively for the purposes of business and as such the learned CIT(A) dismissed the ground raised by the assessee vide appellate orders of the learned CIT(A) dated 02-01-2012 .

18. The next ground is with regard to disallowance of Rs. 60,000/- paid to the advocate. Before the learned CIT(A) the assessee did not submit any explanation, hence, A.O.'s action was confirmed by the learned CIT(A) vide appellate orders dated 02-01-2012 .

19. Similarly, in the next ground the assessee challenged the disallowance of Rs. 16,862/- @10% being incurred out of repairs and maintenance expenses of Rs.1,68,626/-. No argument was advanced by the assessee during appellate proceedings before the learned CIT(A) and hence the A.O.'s action was confirmed by the learned CIT(A).

20. Aggrieved by the appellate orders dated 02-01-2012 of the learned CIT(A), the assessee is in appeal before the Tribunal.

21. The learned Counsel for the assessee submitted that the compensation of Rs. 2,40,35,000/- was paid to M/s Pyramid Retail & Merchandising Pvt. Ltd. for cancellation of agreement with a view to generate more income from fresh agreement of leave and license with Pantaloon. Income earned from

Pyramid was assessed under the head income from house property. The A.O. has not allowed deduction u/s 37(1) of the Act nor it was allowed deductions under the heads income from house property. The ld. Counsel argued that the payment of Rs. 2,40,35,000/- should be allowed as deduction as it was paid for generating more income to the assessee by way of higher license fee as well as higher interest free deposit of Rs.120 lacs from Pantaloon instead of Rs.50 lacs received from Pyramid.

22. The ld. D.R. submitted that there is a cancellation of agreement with M/s Pyramid Retail & Merchandising Pvt. Ltd. and this payment of Rs.2,40,35,000/- for payment of compensation/damages for breach of contract as well to cover the cost of Pyramid is not allowable as deduction from income from house property nor is it allowable as deduction u/s 37(1) of the Act. The learned DR relied upon the orders of the authorities below.

23. We have considered the contentions of both the parties and also perused the material available on record including the case laws cited by the party. We have observed that the assessee is the owner of the property "Hermes Plazzo" situated at Convent Street, Camp, Pune which has been given on leave and license basis to M/s Pyramid Retail & Merchandising Pvt. Ltd. w.e.f. 1st April, 2001 for a period of 10 years. The assessee had received interest free deposit of Rs. 50 lacs from M/s Pyramid Retail & Merchandising Pvt. Ltd.. The income from the leave and license agreement with Pyramid has been assessed to tax under the head 'income from house property'. The assessee has now got a better offer from M/s Pantaloon who had agreed to pay interest free deposit of Rs. 1,20,00,000/- and the minimum business conducting charges from M/s Pantaloon was agreed @ 2% of net sales on monthly basis with a provision for increase by 20% at the end of every block of three years. The assessee wanted to terminate the agreement with said M/s Pyramid Retail & Merchandising Pvt. Ltd. prior to its completion to get

early vacation of premises so that the premises can be given on leave and license basis to Pantaloon who have now offered better terms , the said Pyramid had incurred expenses from time to time on account of alteration, renovation, modification and extra work to build the shopping outlet in the shopping mall given to them on leave and license basis by the assessee and the said Pyramid wanted to be compensated by way of damages/reimbursements for the afore-stated costs incurred for alterations, modification, renovations and extra work to build the shopping outlets in shopping malls as well damages for breach of contract by way of early termination of leave and license agreement by the assessee with Pyramid which led to loss of source of revenue for Pyramid. Since it was a pre-matured termination of agreement with M/s Pyramid Retail & Merchandising Pvt. Ltd., a consolidated compensation of Rs. 2,40,35,000/- was agreed to be paid by the assessee to the said Pyramid. In our considered view, the assessee has made payment to M/s Pyramid Retail & Merchandising Pvt. Ltd. for pre-mature termination of contract to cover damages/reimbursements for various costs incurred by the said M/s Pyramid Retail & Merchandising Pvt. Ltd. on account of alteration, modification, renovation and extra work to build the shopping outlets in the mall as well damages for breach of contract i.e. early termination of leave and license agreement leading to loss of source of revenue for the said Pyramid. We have carefully gone through the provisions of the Act. In our considered view, this payment is not allowable under the provisions of Section 23 and 24 of the Act governing income from house property nor the same is allowable as business expenditure or business loss under the head 'Income from Business or Profession'. In our considered view, this payment has been made by the assessee to get the premises vacated early by making payment for damages for breach of contract due to early termination of leave and license agreement leading to loss of source of income as well as to compensate Pyramid for the cost incurred towards alteration, modification, renovation and extra work to build the licensed premises fit as

shopping outlet in the shopping mall, which costs incurred by Pyramid were primarily on capital field and also in our considered view the afore-stated payment of Rs.2,40,35,000/- made by the assessee to Pyramid is on capital field . Income Tax Act,1961 is a code in itself and allowability of deductions from the income computed under the provisions of the Act has to fall within the four corners of the provisions of the Act . We have observed that income earned from leave and license agreement with Pyramid is charged to tax under the head 'Income from House Property' and this payment of Rs.2,40,35,000/- made by the assessee to Pyramid for pre-mature termination of contract to cover damages/reimbursements for various costs incurred by the said M/s Pyramid Retail & Merchandising Pvt. Ltd. on account of alteration, modification, renovation and extra work to build the shopping outlets in the mall as well damages for breach of contract i.e. early termination of leave and license agreement leading to loss of source of revenue for the said Pyramid is not connected with earning of rental income nor this payment is allowable as deduction from 'Income from House Property' as Chapter IV-C which governs computation of 'income from house property' vide Section 22 to 27 of the Act does not provide for the deduction of the such payments. Similarly, the assessee is not into the business of letting of premises and the said payment is not incurred wholly and exclusively for the purposes of business carried on by the assessee as is stipulated u/s 37(1) of the Act and hence the same cannot be allowed as business loss or business expenditure as the said payment has no nexus or connectivity with the business carried on by the assessee. Hence we hold that this payment of Rs.2,40,35,000/- made by the assessee to Pyramid for pre-mature termination of contract to cover damages/reimbursements for various costs incurred by the said M/s Pyramid Retail & Merchandising Pvt. Ltd. on account of alteration, modification, renovation and extra work to build the shopping outlets in the mall as well damages for breach of contract i.e. early termination of leave and license agreement leading to loss of source of

revenue for the said Pyramid is capital in nature and is not connected with the business of the assessee nor the same can be allowed as deduction while computing income from house property and the same cannot be allowed as deduction under the provisions of the Act, hence, this ground of appeal filed by the assessee is dismissed. We order accordingly.

24. In the next ground, the assessee challenged the disallowance of Rs. 4,32,000/- out of interest expenses which has been computed proportionately on the interest-free advances of Rs. 300 lacs given to M/s Modi Milk & Agro Product Pvt. Ltd. which was stated to be out of borrowed funds of Rs.13.99 crores received from HDFC Bank Limited. We find that the assessee has borrowed new secured interest bearing loan of Rs. 13.99 crores from HDFC Bank. The assessee had advanced an interest free loan of Rs. 3 crores to M/s Modi Milk & Agro Product Pvt. Ltd. whereby the A.O. has worked out proportionate interest of Rs. 4,32,000/- on such interest free loan deposit of Rs. 3 crores which was added to the income of the assessee. The assessee relied on the decision of Hon'ble Bombay High Court in the case of Reliance Utilities and Powers Ltd.(2009) 313 ITR 340(Bom.). It is the say of the ld. Counsel for the assessee that no disallowance can be made as there is a mixed fund which has been utilized for the purpose of loan of Rs.300 lacs to M/s Modi Milk & Agro Product Pvt. Ltd.

25. The ld. D.R., on the other hand, submitted that the assessee has not submitted any details of the loan of Rs. 300 lacs granted to Modi Milk & Agro Product Pvt. Ltd. and the authorities below are right in computing the proportionate disallowance of interest of Rs. 4,32,000/-.The learned DR relied upon orders of the authorities below.

26. We have considered the rival contentions and also perused the material available on record. We have observed that the assessee has received secured

loan of Rs. 13.99 crores from HDFC Bank. The assessee has also granted interest free loan of Rs. 3 crores to M/s Modi Milk & Agro Product Pvt. Ltd. out of which proportionate interest of Rs. 4,32,000/- was disallowed as the assessee granted interest free loans and advances on the allegation that the said loan was granted out of interest bearing borrowed funds. It is the say of the assessee that there is a mixed pool of funds which has been utilized for the purpose of loan of Rs. 300 lacs to M/s Modi Milk & Agro Product Pvt. Ltd. The reliance was placed by the assessee on the judgments of the Hon'ble Bombay High Court in the case of Reliance Utilities and Powers Ltd. (supra) and HDFC Bank Limited v. CIT [2016] 67 taxmann.com 42 (Bombay) wherein it was held that if both borrowed funds and interest free funds were available, then presumption will arise that interest free funds are utilized by the assessee for granting interest free loans and advances. Thus, in our considered view, quantum of availability of both interest free funds as well as non-interest free funds were to be seen vis-à-vis grant of interest free loans and advances to arrive at presumption of utilization of interest free funds for grant of interest free loans and advances. The assessee is directed to produce necessary evidence before the A.O. to demonstrate that mixed funds i.e interest bearing funds as well interest free funds were available with the assessee and the assessee is entitled for the presumption of utilization of interest free funds for grant of interest free loans and advances. The A.O. is directed to decide the issue in accordance with the directions given by the Hon'ble Bombay High Court in the case of Reliance Utilities and Powers ltd. (supra) and HDFC Bank Limited(Supra). Thus, this issue is set aside to the file of the AO for de-novo determination of the issue on merits in accordance with ratio of law laid down by Hon'ble Bombay High Court in afore-stated case of Reliance Utilities and Powers ltd. (supra) and HDFC Bank Limited(Supra). We order accordingly.

27. With respect to the disallowance of Rs. 60,000/- on account of payment made to the Advocate for some other projects being undertaken not by the assessee but by the joint venture , it was submitted by the ld. Counsel that these fees were paid for legal works of Lunkad Amazon & Lunkad Hermes. The learned DR relied on the orders of the authorities below. The payment of Rs. 60,000/- were paid for joint venture project which does not relate to the assessee firm, thus in our considered view , these expenses of Rs. 60,000/- cannot be allowed as deduction for the purpose of computation of business as conditions laid down u/s 37(1) of the Act are not fulfilled as the expenses are not incurred wholly and exclusively for the purposes of the business of the assessee. We order accordingly

28. During the year the assessee has debited an amount of Rs. 1,68,626/- on account of repairs and maintenance expenses whereby the authorities below have disallowed 10% of the above expenses i.e. Rs.16,826/- on the ground that the assessee has produced self generated vouchers and the payment has been made in cash. The ld. Counsel for the assessee submitted that the disallowance has been made on adhoc basis. Books of account have not been rejected by the A.O.

29. The ld. D.R. relied upon the orders of the authorities below.

30. In our considered view such ad-hoc disallowance of expenses cannot be sustained more-so no defects have been pointed by the Revenue and books of the accounts are also not rejected There is no allegation that these expenses were not incurred or were wrongly claimed by the assessee. It is also not brought on record that these expenses were not incurred wholly and exclusively for the purposes of business of the assessee. Under these circumstances, we are of the view that this additions of Rs.16,826/- cannot be sustained and we order deletion of the said addition of Rs.16,826/- to the

income of the assessee on account of repairs and maintenance expenses . We order accordingly.

31. In the result, the appeal filed by the assessee-Ramesh Builders(India) in ITA NO. 1797/Mum/2012 for the assessment year 2007-08 is dismissed and the appeal of the assessee- Ramesh Builders in ITA No. 1798/Mum/2012 for the assessment year 2007-08 is partly allowed.

Order pronounced in the open court on 27<sup>th</sup> July , 2016.

आदेश की घोषणा खुले न्यायालय में दिनांक: 27-07-2016 को की गई ।

Sd/-  
(SAKTIJIT DEY)  
JUDICIAL MEMBER

sd/-  
(RAMIT KOCHAR)  
ACCOUNTANT MEMBER

मुंबई Mumbai; दिनांक Dated 27-07-2016

व.नि.स./ R.K., Ex. Sr. PS

**आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :**

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT(A)- concerned, Mumbai
4. आयकर आयुक्त / CIT- Concerned, Mumbai
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai "D" Bench
6. गार्ड फाईल / Guard file.

सत्यापित प्रति //True Copy//

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt. Registrar)  
आयकर अपीलीय अधिकरण, मुंबई/ ITAT, Mumbai