

Sum received by partners towards their share in assets on retirement from firm is not liable to capital gain tax

Summary – The High Court of Bombay in a recent case of Electroplast Engineers., (the Assessee) held that sum received by partners towards their share in assets on retirement from firm is not liable to capital gain tax

Facts

- Under a Deed of Retirement cum Reconstitution of the Partnership Goodwill was evaluated and the retiring partners were paid certain sum for their share of goodwill in proportion of their share in partnership. The assessee-partnership firm filed return of income.
- The Assessing Officer believed that that the goodwill was capital gain arising on distribution of the capital asset by way of dissolution of the firm or otherwise and the partnership firm was liable to pay pay short-term capital gain tax in terms of section 45(4).
- The Commissioner (Appeals) held section 45(4) would apply since the rights and interests in assets of the firm were transferred to the new members and it amounted to transfer of capital asset.
- The Tribunal held that section 45(4) would apply only in a case where there has been dissolution of the firm and, thus, the conditions required for applying section 45(4) were not satisfied.
- On the revenue's appeal before the High Court:

Held

- As per the provision of section 45(4), profits or gains arising from transfer of capital asset by way of distribution of capital asset on dissolution of firm or otherwise shall be chargeable to tax as income of the firm. For the application of this provision, thus, transfer of capital asset is necessary.
- High Court observed that it was held in many judicial precedents that in case after the retirement of the partners, the partnership continued and the business is carried on by the remaining partners, there was no dissolution of the firm and there was no distribution of capital asset. What is given to the retiring partners is money representing the value of their share in the partnership and in such case no capital asset is transferred on the date of retirement.
- Since the instant case was similar, there was clearly no transfer of capital asset.