Sum received by partner on retirement from firm is exempt from tax: ITAT

Summary – The Mumbai ITAT in a recent case of James P. D'Silva, (the Assessee) held that Share of capital along with accrued profit, goodwill, brokerage/commission and payment made to assessee in realisation of his share in net value of assets of firm on his retirement are not liable to be taxed as capital gains and also under section 28(v)

Advances received by assessee in earlier assessment years could not be brought to tax as unexplained cash credit under section 68 in relevant/current assessment year

Facts

- The assessee, an individual engaged in business of real estate and film production, was partner in the partnership firm BCI. As the disputes arouse among the partners the assessee was forced to retire from the firm. Accordingly, the deed for release was signed and the assessee retired from the partnership. The assessee was not paid his share of capital and profits of the firm as promised in the release deed. The assessee approached the Court for appointment of Court receiver to protect his interest in the firm. Finally, the assessee and the partners settled the dispute by entering into consent terms. Based on the consent terms the civil miscellaneous application filed by the assessee in the Court of District Judge was disposed off on 4-4-2012 in terms of the consent terms filed before the District Judge. The assessee received Rs. 5.43 crores on account of share capital and accrued profit. Rs. 1 crore on account of goodwill of the firm and Rs. 12.73 crores on account of brokerage/commission.
- The Assessing Officer while completing the assessment held that the assessee retired as partner from the firm during the year under consideration and as part of settlement an amount of Rs.1 crore was quantified as goodwill to be received by the assessee and the partners shares and rights in the firm is a capital asset within the section 2(14) and extinguishment of such right would amount to transfer as per clauses (*i*) and (*ii*) of section 2(47). He further observed that any distribution of capital assets on the dissolution of a firm would come within the definition of transfer. The Assessing Officer concluded that there was a transfer of interest of the retiring partner over the assets of the partnership firm on her retirement and, therefore, there was a liability to tax on account of capital gains. Hence, goodwill was assessed as capital gains in the hands of the assessee.
- On appeal, the Commissioner (Appeals) also sustained the additions made by the Assessing Officer.
- On second appeal:

Held

- An amount of Rs. 6.66 crores is received and/or debited in the account of the applicant for share capital and accrued profit and goodwill of the firm, thereby leaving an additional payment of Rs. 32.66 lakhs which has been received by the applicant the same amount shall be reduced in the brokerage/commission receivable by the applicant. Rs. 12.73 crores towards brokerage/commission shall be payable by the opponents jointly and severally to the applicant unconditionally and without any deductions in five equal monthly instalments of Rs.2.54 crores each, provided however an amount of Rs.32.66 lakhs shall be reduced from the first instalment payable to the applicant, for which the opponents have already issued 5 post dated cheques, as per the details mentioned here under and the same shall be honoured on its presentation on the date mentioned in the cheques.

- The issue of whether the goodwill received by the assessee on retirement is liable for capital gains tax or not has been concluded by the Jurisdictional High Court in the case of *Prashant S. Joshi* v. *ITO* [2010] 189 Taxman 1/324 ITR 154 (Bom.) wherein it was held that when an amount paid to a partner upon retirement after taking accounts and upon deduction of liabilities there is no involvement of an element of transfer within section 2(47).
- Payment made to partner in realization of his share in the net value of the assets upon his retirement from the firm, does not fall under clause (*v*) of section 28. It is not in dispute that the assessee retired from BCI by virtue of consent terms entered into among the partners including the assessee which was settled in the Court of law as the assessee approached the District Court for appointment of a receiver and to protect the properties as there was a dispute among the partners, and finally the case was disposed off on 4-4-2012 by the District Judge in civil Miscellaneous Application and closed the proceedings in terms of the consent application filed by the assessee and the existing partners. It is not in dispute that by virtue of the consent terms the assessee finally agreed for settlement and quantified the amount payable to him on his retirement from the firm at Rs. 19.07 crores comprising of Rs. 5.34 crores towards share capital and accrued profit, Rs. 1 crore towards goodwill and Rs. 12.73 crores towards brokerage/commission. Though it was settled in the consent deed that Rs. 12.73 crores was paid towards brokerage and commission in effect these amounts was paid to the assessee in realisation of his share in the net value of assets upon his retirement from the firm BCI. The firm continued with the existing partners and the assessee on his retirement from the firm was entitled to the sums as specified in the consent terms. However, the Assessing Officer brought to tax the amounts settled through settlement deed *i.e.* share of capital and share in profits, commission/brokerage and goodwill on assessee retirement from BCI.
- The share of capital along with accrued profit, goodwill and brokerage/commission which were received/receivable in terms of consent deed entered among the partners on account of retirement of the assessee from the partnership firm and the payment made to the assessee in realisation of his share in the net value of the assets of the firm on his retirement are not liable to be taxed as capital gains and also under section 28(*v*). Thus, the Assessing Officer is directed to delete the additions made towards, goodwill Rs.1 crore, share capital and share of profit of Rs. 9.41 crores and the brokerage/commission of Rs. 12.73 crores and recompute the income for the year under consideration.