

VATSALA SHENOY

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v.

JOINT COMMISSIONER OF INCOME TAX  
(ASSESSMENT), MYSORE

(Civil Appeal No. 1234 of 2012)

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OCTOBER 18, 2016

[A. K. SIKRI AND N.V. RAMANA, JJ.]

*Income Tax Act, 1961:*

*ss. 2(14), 45 – Capital asset – Profit/gain arising from transfer thereof to be taxed as “Capital gains” – Assessee, erstwhile partners of a dissolved partnership firm – Winding up proceedings filed to sell the assets of the firm and distribute the share thereof – Firm sold as an ongoing concern to three partners forming Association of Persons (AOP-3) – Assessee/erstwhile partners received their net share of the value of the assets of the firm – Taxed as capital gains in the hands of assessee by Assessing Officer – Held: Result of winding up proceedings, after dissolution of firm, was to sell the assets of the firm and distribute the share thereof – On facts, it is clear that asset of the firm that was sold was capital asset within the meaning of s. 2(14) of the Act – Thus, once it is held to be the “capital asset”, gain therefrom is to be treated as capital gains within the meaning of s. 45 – Capital gains u/s. 45 is deemed income which arises at a fixed point of time, viz. on the date of transfer – ‘Transfer’ of the assets triggered the provisions of s.45, making the capital gains subject to payment of tax at the hands of assessee – However, business income/revenue income of the firm in the Assessment Year in question to be assessed at the hands of AOP-3 and not assessee – Companies Act, 1956 – s.583(4)(a) – Tax/Taxation.*

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*s.2(42)C – Slump Sale – When not – Held: As per the definition of ‘slump sale’, sale in question could be treated as slump sale only if there was no value assigned to the individual assets and liabilities in such sale – In the present case, not only value was assigned to individual assets, even liabilities were taken care of – Hence, sale in question not slump sale.*

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**Partly allowing the appeals by assessee, the Court**

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A           **HELD: 1.1** The firm stood dissolved with effect from  
December 06, 1987; the company petition was filed by two  
partners in view of eruption of disputes among the partners; the  
business was carried on by the partners with controlling interest  
as an interim arrangement; the income was assessed in their  
B           hands as AOP and not in the hands of the firm which had already  
been dissolved; assets of the company were put to sale in  
accordance with the Partnership Deed of a dissolved firm, though  
as an ongoing concern; and outgoing partners (assessee herein)  
received their net share of the value of the assets of the firm out  
of the amount received by way of sale of the assets of the firm as  
C           per the Partnership Deed. On the aforesaid facts, it becomes  
clear that asset of the firm that was sold was the capital asset  
within the meaning of Section 2(14) of the Act. Once it is held to  
be the “capital asset”, gain therefrom is to be treated as capital  
gains within the meaning of Section 45 of the Act. [Paras 24, 27]  
D           [18-E-H; 19-A]

**1.2** Capital gains under Section 45 of the Act is deemed  
income which arises at a fixed point of time, viz. on the date of  
transfer. When the said legal principle is applied to the facts of  
the instant case, it is found that the partnership firm had dissolved  
and thereafter winding up proceedings were taken up in the High  
E           Court. The result of those proceedings was to sell the assets of  
the firm and distribute the share thereof to the erstwhile partners.  
Thus, the ‘transfer’ of the assets triggered the provisions of  
Section 45 of the Act and making the capital gains subject to the  
payment of tax. [Paras 27, 28] [20-G-H; 21-A-B]

F           **1.3** The assessee, however, were attempting to wriggle  
out from payment of capital gains tax on the ground that it was a  
“slump sale” within the meaning of Section 2(42)C of the Act and  
there was no mechanism at that time as to how the capital gains  
is to be computed in such circumstances, which was provided for  
G           the first time by Section 50B of the Act with effect from April 01,  
2000. As per the definition of ‘slump sale’ in Section 2(42)C, sale  
in question could be treated as slump sale only if there was no  
value assigned to the individual assets and liabilities in such sale.  
This had obviously not happened. Not only value was assigned to  
individual assets, even the liabilities were taken care of when  
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the amount of sale was apportioned among the outgoing partners, i.e. the assessee herein. Once it is held that the sale in question was not slump sale, obviously Section 50B also does not get attracted as this section contains special provision for computation of capital gains in case of slump sale. [Paras 25, 26] [19-A-B; F-H]

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1.4 There is merit in the submission of the assessee that income of the firm in the Assessment Year in question could not be taxed at the hands of the assessee. First, and pertinently, it is an admitted case that 40% of the said income was allowed by the High Court to be retained by the successful bidder (AOP-3) precisely for this very purpose. This 40% represented the tax which was to be paid on the income generated by the ongoing concern being run by the Association of Persons, as authorised by the High Court. Secondly, in the previous years, the Department had taxed the AOP and this procedure had to continue in the Assessment Year in question as well. Therefore, the business income/revenue income in the Assessment Year in question is to be assessed at the hands of AOP-3, in terms of the orders of the High Court, as AOP-3 retained the tax amount from the consideration which was payable to the assessee herein and it is AOP-3 which was supposed to file the return in that behalf and pay tax on the said revenue income. [Paras 32, 33, 34] [24-B-D, G-H]

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*PNB Finance Limited v. Commissioner of Income Tax I, New Delhi* (2008) 13 SCC 94 : 2008 (15) SCR 556 – held inapplicable.

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*Commissioner of Income Tax, Faridabad v. Ghanshyam (HUF)* (2009) 8 SCC 412 : 2009 (10) SCR 1025 – held applicable.

*M/s. Radhasoami Satsang, Saomi Bagh, Agra v. Commissioner of Income Tax* (1992) 1 SCC 659 : 1991 (2) Suppl. SCR 312; *Commissioner of Income Tax v. Excel Industries Ltd.* (2014) 13 SCC 459 : 2013 (10) SCR 490 – relied on.

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*Commissioner of Income Tax, Bombay City I v. Tata Services Ltd.* (1980) 122 ITR 594 (Bombay); *Mangalore*

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- A *Ganesh Beedi Works v. Commissioner of Income Tax, Mysore & Anr.* (2016) 2 SCC 556; *CIT v. B.C. Srinivasa Setty* (1981) 2 SCC 460:1981 (2) SCR 938; *Areva T & D India Ltd. v. The Deputy Commissioner of Income Tax* (2012) 345 ITR 421; *Commissioner of Income Tax & Anr. v. Associated Electronics, & Electricals Industries (Bangalore) (P) Ltd.* (2016) 130 DTR 0222 (Kar) – referred to.

Case Law Reference

- |   |  |                   |         |
|---|--|-------------------|---------|
|   | (1980) 122 ITR 594 (Bombay)                                  | referred to       | Para 15 |
| C | 2008 (15) SCR 556  | held inapplicable | Para 16 |
|   | (2016) 2 SCC 556   | referred to       | Para 17 |
|   | 1981 (2) SCR 938   | referred to       | Para 18 |
|   | (2012) 345 ITR 421   | referred to       | Para 18 |
| D | (2016) 130 DTR 0222 (Kar)                                    | referred to       | Para 18 |
|   | 2009 (10) SCR 1025   | held applicable   | Para 27 |
|   | 2013 (10) SCR 490  | relied on         | Para 33 |
|   | 1991 (2) Suppl. SCR 312                                      | relied on         | Para 33 |
| E | CIVIL APPELLATE JURISDICTION: Civil Appeal No. 1234 of 2012. |                   |         |

From the Judgment and Order dated 23.12.2010 of the High Court of Karnataka at Bangalore in ITA No. 147 of 2000.

- F WITH

C. A. Nos. 1235, 1236, 1237, 1238, 1239, 1240, 1241, 1242, 1243, 1244 and 1245 of 2012.

C. A. Nos. 10190, 10191 and 10192 of 2016.

- G Ajay Vohra, Sr. Adv., Mohit Chaudhary, Ms. Puja Sharma, Kunal Sachdeva, Ms. Damini Chawla, Balwinder S., Iman Ali, Yashraj Singh Deora, Ashok Kulkarni, Ms. Priyadar Shinee Singh, Ms. Asmita Singh, M/s. Mitter & Mitter Co., Advs. for the Appellant.

- H K. Radhakrishnan, Sr. Adv., Rupesh Kumar, Arijit Prasad, T. M. Singh, Pratik Raoka, Mrs. Anil Katiyar, Advs. for the Respondent.

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The Judgment of the Court was delivered by

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**A.K. SIKRI, J.** 1. Delay condoned in Special Leave Petition  
(C) No.....CC 9101 and 10193 of 2014.

2. Leave granted.

3. All these appeals (except Civil Appeal No. 1245 of 2012 and  
Civil Appeals arising out of SLP (C) No....CC Nos. 9101 and 10193 of  
2014 and SLP (C) No. 14812 of 2014, which are filed by the Revenue)  
are preferred by the assesseees. The respondent in these appeals is the  
Joint Commissioner of Income Tax (Assessment), Special Range, Mysore,  
who would be referred to as the 'Revenue' hereinafter. It may also be  
mentioned that these appeals arise out of a common judgment rendered  
by the High Court of Karnataka on December 23, 2010 in the appeals  
filed under Section 260-A of the Income Tax Act, 1961 (for short, the  
'Act') challenging certain aspects of assessments pertaining to the  
Assessment Year 1995-1996. In fact, as would be noticed hereinafter,  
all these assesseees were partners of a partnership firm known as 'M/s.  
Mangalore Ganesh Beedi Works', which was sold to three other partners,  
as a going concern, but after the dissolution of the partnership firm.  
Certain considerations received as a result thereof were treated as capital  
gains on which income tax was charged by the Assessing Officer. The  
case of the assesseees was that it was a capital receipt in their hands, not  
exigible to income tax. The exact nature of the receipt, treated as capital  
gain by the Assessing Officer, shall be taken note of subsequently at the  
appropriate stage. Suffice it to state that the assesseees successive appeals  
to Commissioner of Income Tax (Appeals) and then to the Income Tax  
Appellate Tribunal (ITAT) and thereafter to the High Court have failed,  
thereby sustaining the order of the Assessing Officer. With this brief  
background of the litigation, we advert to the events that have taken  
place in some detail.

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4. One S. Raghuram Prabhu started the business of manufacturing  
beedies in the year 1939. His brother-in-law joined him in the year 1940  
and this sole proprietorship was converted into a partnership firm with  
the name 'M/s. Mangalore Ganesh Beedi Works' (hereinafter referred  
to as the 'firm'). It was reconstituted thereafter from time to time and  
lastly on June 30, 1982. Partnership deed dated June 30, 1982 was  
entered between thirteen persons with the same name. Duration of this  
firm was five years, which period could be extended by six months.  
Thereafter, the affairs of the firm had to be wound up as provided in

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- A Clause 16 of the Partnership Deed. The firm was dissolved on December 06, 1987 by afflux of time after extending the life of the firm by a period of six months, as per the terms stipulated in the Partnership Deed. However, because of the difference of opinion among the erstwhile partners, the affairs of the firm could not be wound up. Therefore, two
- B of the partners of the firm filed a petition before the High Court under the provisions of Part X of the Companies Act, 1956 for winding up of the affairs of the firm in terms of Section 583(4)(a) thereof. The said petition was registered as Company Petition No. 1 of 1988. Significantly, though the firm stood dissolved on December 06, 1987, and thereafter Company Petition No. 1 of 1988 for the winding up proceedings after
- C dissolution was filed in the High Court, the business of the partnership firm continued because of the interim order passed by the High Court. This was because of the agreement of the partners, as stipulated in the Partnership Deed itself, providing that on dissolution the firm was to be sold as a continuing concern to that partner(s) who could give the highest price therefor. The relevant clauses in the partnership firm stipulating
- D the aforesaid arrangement are clauses (3) and (16) which read as under:

E “3. The duration of the Partnership shall be five years in the first instance; but by mutual agreement the parties hereto may extend the said duration. If during the subsistence of this Partnership any of the partners desire to retire from the partnership he or she can do so, if all the other partners agree to the said retirement. However, if all the other partners do not agree to the said retirement, the partner intending to retire shall give six months’ notice in writing of his or her intention to retire and on expiration of the period

F of the said notice the said Partner shall cease to be a Partner and subject to Para 14 infra from that date all his or her liabilities and rights as a Partner of the firm shall come to an end.

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- G 16. If the Partnership is dissolved, the going concern carried on under the name of the Firm MANGALORE GANESH BEEDI WORKS and all the trade marks used in course of the said business by the said firm and under which the business of the Partnership is carried on shall vest in and belong to the Partner who offers and pays or two or more

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Partners who jointly offer and pay the highest price therefor as a single group at a sale to be then held as among the Partners shall be entitled to bid. The other Partners shall execute and complete in favour of the purchasing Partner or Partners at his/her or their expense all such deed, instruments and applications and otherwise aid him/her or them for the registration his/her name or their names of all the said trade marks and do all such deed, acts and transactions as are incidental or necessary to the said transferee or assignee Partner or Partners.”

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5. In view of the aforesaid clauses, specific order dated November 05, 1988 was passed by the High Court permitting the group of partners, seven in number, who had controlling interest, to continue the business as an interim arrangement till the completion of winding up proceedings. Ultimately, the orders dated June 14, 1991 were passed in the said company petition for winding up the affairs of the firm by selling its assets as an *'ongoing concern'*. Though this order was challenged by some of the partners by filing special leave petition in this Court, the same was dismissed as withdrawn in the year 1994. In this manner, orders dated June 14, 1991 became final, which had permitted the sale of the firm, as an ongoing concern, to such of its partner(s), who makes an offer of highest price. Reserve price of ₹30 crores was also fixed thereby mandating that the price cannot be less than ₹30 crores. The successful bidder was also required to accept further liability to pay interest @ 15% per annum towards the amount of price payable to partners from December 06, 1987 till the date of deposit. In the order dated June 14, 1991, it was also directed that the successful bidder shall deposit the offer price together with interest with the Official Liquidator within a period of sixty days of the date of acceptance of the offer.

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6. On the aforesaid terms, these partners individually or in groups offered their bids. Bid of Association of Persons comprising three partners (hereinafter referred to as 'AOP-3'), at ₹92 crores, turned out to be the highest and the same was accepted by the High Court vide order dated September 21, 1994. AOP-3 deposited this amount of ₹92 crores with the Official Liquidator on November 17, 1994 and with the occurrence of this event, assets of the firm were treated as having been sold to AOP-3 on November 20, 1994. Even actual handing over of the business of the firm along with its assets by the Official Liquidator to the said AOP-3 took place on January 07, 1995.

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A 7. From the aforesaid facts, following events which are relevant for the purposes of these appeals, are recapitulated:

(i) Date of dissolution of the partnership firm is December 06, 1987.

B (ii) Company Petition No. 1 of 1988 was filed in the High Court of Karnataka for winding up of the firm. All steps and formalities for winding up, thereafter, are taken pursuant to the orders passed by the High Court from time to time.

C (iii) Order dated November 05, 1988 is passed permitting the group of partners (seven in number) to continue the business as an interim arrangement till the completion of winding up proceedings.

(iv) Winding up order dated June 14, 1991 is passed fixing minimum price of ₹30 crores for the sale of the dissolved partnership firm as a going concern to such of its partner(s) who makes the offer of highest price.

D (v) The date of deposit of the bid amount of ₹92 crores by AOP-3, being the highest bid, is on November 17, 1994.

8. With the aforesaid background facts, we advert to the developments that have taken place on the income tax front.

E 9. Since the firm stood dissolved with effect from December 06, 1987, upto December 06, 1987, it is the firm which had filed the income tax returns in respect of the income which it had earned, for payment of income tax thereupon. However, as mentioned above, though the firm was dissolved, but the business continued because of the orders passed by the High Court keeping in view the provisions contained in the Partnership Deed. The income that was earned from the date of dissolution till the date of winding up and when the firm was sold to F AOP-3 was assessed at the hands of dominant partners controlling the business activities (seven in number) as "Association of Persons" (AOP), meaning thereby, the income from the business of the said firm G December 06, 1987 till winding up was assessed as an AOP. At the same time, these assesseees were also filing their individual returns as well.

H 10. The assesseees filed the return for the Assessment Year 1995-1996. It is in this Assessment Year the assets of the firm were sold as ongoing concern to AOP-3 on September 21, 1994. The Assessing



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Officer, while making the assessments, bifurcated this Assessment Year into two periods. One period from April 01, 1994 to November 20, 1994 (as AOP of the partners who had continued the business in that capacity in previous years). Second period from November 20, 1994 till March 31, 1995 (as the business was handed over to AOP-3 and the assessment was treated as that of AOP-3). While doing so, the Assessing Officer observed that the entire capital gains on the sale as a going concern of the business of the firm as well as the proportionate profits for the period April 01, 1994 to November 20, 1994, when the controlling AOP was carrying on business as computed in accordance with the order of the High Court in Company Petition No. 1 of 1988, on a notional basis a sum of ₹9,57,57,007 should be taxed in the hands of the firm. However, according to the Assessing Officer, to protect interests of the Revenue, the same amounts were included in the assessment of the AOP for the first period. The income and tax computations were made separately for the two periods in the order of assessment. The Assessing Officer apportioned the consideration among the various assets comprised within the business with further splitting between short term and long term capital gains.

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11. While the aforesaid treatment was given to the assessment of the income of the firm, insofar as the assessee as individuals are concerned, on the same date the Assessing Officer made assessment in their cases also by including therein the proportionate share from out of ₹92 crores (the amount of auction bid) as capital gain at their hands and bifurcated the same into long term and short term gain. The manner in which it is done can be discerned from one such Assessment Order where the capital gain is computed in the following manner:

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“INCOME AS RETURNED Rs.29,40,680

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II. Computation of capital gains on account of transfer of interest in partnership firm M/s. MGBW out of Rs. 92 crores

Share of assessee out of Rs. 92 crores Rs. 12,73,55,600

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Goodwill u/s. 48 r.w.s.

55(1)

76.6% of Rs.12,73,55,600 Rs.9,75,54,390

(See Table 3)

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|   |  |                 |                         |
|---|--|-----------------|-------------------------|
| A | less Cost of acquisition   | nil             |                         |
|   | <b>(See Table 3)</b>   |                 |                         |
|   | Net Taxable Goodwill   |                 | Rs. 9,75,54,390         |
|   | <b><u>A 2</u></b>  |                 |                         |
| B | Sale of Land   |                 |                         |
|   | (See Table 3)  |                 |                         |
|   | Market value @ 19% of  | Rs.12,73,55,600 |                         |
|   | less Cost of acquisition   | Rs.2,41,97,564  |                         |
| C | (see Table 3)  |                 |                         |
|   | 13.843% of   |                 |                         |
|   | Rs.1,53,45,025   |                 |                         |
|   | Indexed Cost   | 21,24,221x259   |                         |
|   |  | 100             |                         |
| D |  | 55,01,710       | Rs.1,86,95,854          |
|   | <b>TOTAL LONG TERM CAPITAL GAINS (A1+A2) Rs. 11,62,50,244</b>                                |                 |                         |
|   | <b><u>III Short-term Capital gain on transfer of movable (depreciable asset) u/s. 50</u></b> |                 |                         |
| E | 4.4% of Rs.12,73,55,600  | Rs. 56,03,646   |                         |
|   | Less Value / w.d.v. in the beginning of accounting year – 31.03.1994                         |                 |                         |
| F | 13.843% of Rs.15,11,404  | Rs.2,09,224     |                         |
|   | <b>SHORT TERM CAPITAL GAINS</b>  |                 | <b>Rs. 53,94,422</b>    |
|   | <b>IV Share of Notional/Proportionate Profit – revenue receipt</b>                           |                 | <b>Rs. 1,32,55,640</b>  |
|   | <b>TOTAL INCOME (I + II + III + IV)</b>  |                 | <b>Rs. 13,78,40,987</b> |
| G | <b>TOTAL INCOME EXCLUDING LONGTERM CAPITAL-GAINS</b>   |                 | <b>Rs. 2,15,90,743"</b> |

12. As can be gathered from the above, the total proceeds of ₹92 crores are first apportioned among the assessees in the ratio in which

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they had received the said amount. Thereafter, this amount is divided into long term capital gains and short term capital gains. Two components of long term capital gains are taken into consideration, namely goodwill and sale of land. Likewise, short term capital gain is arrived at in respect of transfer of movables which were depreciable assets. For the purposes of calculation/ computation, figures were taken from Table II incorporated in the Assessment Order itself mentioning the market value of these assets. This Table II reads as under:

| S.No. | Asset   | % age  | Sales/Market Value | Amount in assessee's case |
|-------|---|--------|--------------------|---------------------------|
| 1.    | Land as per H.S. Seshagiri – Registered Valuer  | 19.00  | 17,47,90,000       | 2,41,97,564               |
| 2.    | Buildings as per H.S. Seshagiri – Registered Valuer   | 4.10   | 3,80,00,000        | 56,06,646                 |
| 3.    | Plant & Machinery estimated on the basis of Swamy & Rao's Report  | 0.30   | 25,00,000          |                           |
| 4.    | Goodwill – being balancing figure remaining out of total figure of 92,00,00,000 also being almost same figure if super-profit method is adopted | 76.60  | 70,47,10,000       | 9,75,54,390               |
|       | Total   | 100.00 | 92,00,00,000       | 12,73,55,600              |

13. It becomes apparent that the approach adopted by the Assessing Officer was to take into consideration market value of the assets of the firm, viz. land, building and plant & machinery, which had already been evaluated by the Registered Valuers as reflected in the Table above. The market value of these three assets was ₹21,52,90,000. Since total sale consideration at which the firm was sold was ₹92 crores, balance amount of ₹70,47,10,000 was treated as representing goodwill of the firm which was taxed as long term gain. This mode of arriving at

A short term and long term capital gain and taxing it accordingly by the Assessing Officer has received the stamp of approval by the Commissioner of Income Tax (Appeals) and the Income Tax Appellate Tribunal, as well as the High Court.

14. Mr. Ajay Vohra, learned senior counsel appearing for the assessee, submitted, with great emphasis, that the aforesaid approach is incorrect, invalid and impermissible in law. Two broad arguments, on the basis of which he attacked the rationale of the aforesaid assessments, are the following:

(i) After referring to the averments made in the winding up petition that was filed in the Karnataka High Court, order of winding up and the final order of confirmation of sale, Mr. Vohra pointed out that the firm was admittedly sold as a going concern. Predicated on this fact, his submission was that there could not have been any capital gain on the sale of ongoing concern. For this purpose, he drew sustenance from the definition of 'capital asset' as contained in Section 2(14)(a) of the Act as well as Section 45 of the Act. Section 2(14)(a) is to the following effect:

"2(14) "capital asset" means –

(a) property of any kind held by an assessee, whether or not connected with his business or profession;

xx                      xx                      xx"

15. He submitted that the expression '*property of any kind*' was of widest amplitude, as held in *Commissioner of Income Tax, Bombay City I v. Tata Services Ltd.*<sup>1</sup> Therefore, assets of the partnership were to be treated as capital assets.

16. He, thus, argued that undertaking that was transferred as a going concern was a capital asset. However, at that time, there was no provision as to how the asset of the firm when sold is to be computed as a capital gain. The learned counsel pointed out that such a provision was introduced for the first time (vide Finance Act, 1999) by inserting Section 50B to the Act with effect from April 01, 2000, laying down the mechanism for computation of capital gains in case of slump sale. For, such slump sales prior to April 01, 2000 were, therefore, not taxable, was the submission of the learned counsel. It was argued that precisely this very issue had been clinchingly determined by this Court in *PNB*

<sup>1</sup> (1980) 122 ITR 594 (Bombay)

*Finance Limited v. Commissioner of Income Tax I, New Delhi*<sup>2</sup> in A  
the following manner:

“16. In the case of *Artex Manufacturing Co.* this Court found that a valuer was appointed, that valuer submitted his valuation report in which itemized valuation was carried out and on that basis the consideration was fixed at Rs.11,50,400. Therefore, the sale consideration had been arrived at after taking into account the value of plant, machinery and dead stock as computed by the valuer and, consequently, it was held that the surplus arising on the sale was taxable under section 41(2) of the Act and not as capital gains. In the circumstances, the judgment of this court in the case of *Artex Manufacturing Co.* was not applicable to the present case. Further, this court in the case of *CIT v. Electric Control Gear Mfg. Co.* [1997] 227 ITR 278 has held that whether (*sic*) the business of the assessee stood transferred as a going concern for slump sale price, in the absence of evidence on record as to how the slump price stood arrived at, section 41(2) had no application. It is interesting to note that the judgment in the case of *Electric Control Gear Mfg. Co.* is given by the same Bench which decided the case of *Artex Manufacturing Co.* In fact, both the judgments are reported one after the other in 227 ITR at pages 260 and 278 respectively. In the present case, as can be seen from the impugned judgment of the Delhi High Court, the judgment of this court in *Electric Control Gear Mfg. Co.* is missed out. That judgment has not been considered by the High Court. As stated above, this court has clarified its judgment in *Artex Manufacturing Co.* in its judgment in the case of *Electric Control Gear Mfg. Co.* Therefore, section 41(2) has no application to the facts of the present case.

17. As regards applicability of section 45 is concerned, three tests are required to be applied. In this case, section 45 applies. There is no dispute on that point. The first test is that the charging section and the computation provisions are inextricably linked. The charging section and the computation provisions together constituted an integrated

<sup>2</sup> (2008) 13 SCC 94 : 307 ITR 75

A code. Therefore, where the computation provisions cannot apply, it is evident that such a case was not intended to fall within the charging section, which, in the present case, is section 45. That section contemplates that any surplus accruing on transfer of capital assets is chargeable to tax in the previous year in which transfer took place. In this case, transfer took place on July 18, 1969. The second test which needs to be applied is the test of allocation/attribution. This test is spelt out in the judgment of this Court in *Mugneeram Bangur and Co. (Land Department)* [1965] 57 ITR 299. This test applies to a slump transaction. The object behind this test is to find out whether the slump price was capable of being attributable to individual assets, which is also known as item-wise earmarking. The third test is that there is a conceptual difference between an undertaking and its components. Plant, machinery and dead stock are individual items of an undertaking. A business undertaking can consist of not only tangible items but also intangible items like, goodwill, man power, tenancy rights and value of banking licence. However, the cost of such items (intangibles) is not determinable. In the case of *CIT v. B.C. Srinivasa Setty* reported in [1981] 128 ITR 294, this court held that section 45 charges the profits or gains arising from the transfer of a capital asset to income-tax. In other words, it charges surplus which arises on the transfer of a capital asset in terms of appreciation of capital value of that asset. In the said judgment, this Court held that the "asset" must be one which falls within the contemplation of section 45. It is further held that, the charging section and the computation provisions together constitute an integrated code and when in a case the computation provisions cannot apply, such a case would not fall within section 45. In the present case, the banking undertaking, inter alia, included intangible assets like, goodwill, tenancy rights, man power and value of banking licence. On the facts, we find that item-wise earmarking was not possible. On the facts, we find that the compensation (sale consideration) of Rs.10.20 crores was not allocable (*sic*) item-wise as was the case in *Artex Manufacturing Co.*"

17. Mr. Vohra pointed out that in the instant case itself, insofar as AOP-3 is concerned (who were the successful bidders and purchased the assets of the firm), they were treated as purchasers of an ongoing concern by this Court in the case of their assessment in *Mangalore Ganesh Beedi Works v. Commissioner of Income Tax, Mysore & Anr.*<sup>3</sup> A

In nutshell, his argument was that since it was a sale of an ongoing concern, it had to be treated as a slump sale within the meaning of Section 2(42C) of the Act and, therefore, it was not permissible for the Assessing Officer to assign the amount of ₹92 crores into different heads of land, building and machinery and treating balance amount as goodwill. It was a capital asset as an ongoing concern which was sold at ₹ 92 crores and in the absence of provisions relating to mode of computation and deductions at the relevant time, which were inserted subsequently only with effect from April 01, 2000, as per *PNB Finance Limited*, the consideration was to be treated as capital receipt and no capital gain was payable thereon. B C

18. Two incidental submissions were also made on this aspect, which are:

(a) Even if the provisions of capital gain were applicable and the amount was to be taxed as the capital gain, valuation of goodwill, as done by the Assessing Officer, was contrary to law. It was submitted that the manner in which the goodwill was valued showed that cost of acquisition was treated as 'Nil'. However, it could not be so having regard to the provisions of Section 48. He contrasted the same with Section 55(2) which was inserted with effect from April 01, 2002 and deals with 'cost of acquisition' for the purposes of Sections 48 and 49 stipulating that insofar as capital asset in relation to goodwill of a business is concerned, cost of acquisition would be the cost at which it was purchased from the previous owner. According to him, this yardstick could not have been applied prior to April 01, 2002 in the absence of any statutory scheme and the instant case needed to be covered by the law laid down by the courts in this behalf in various judgments. The learned counsel referred to the following judgments in support: D E F

- (i) *CIT v. B. C. Srinivasa Setty*<sup>4</sup>
- (ii) *Mangalore Ganesh Beedi Works*
- (iii) *Areva T & D India Ltd. v. The Deputy Commissioner of Income Tax*<sup>5</sup> G

<sup>3</sup> (2016) 2 SCC 556 : (2015) 378 ITR 640

<sup>4</sup> (1981) 2 SCC 460 : 128 ITR 294

<sup>5</sup> (2012) 345 ITR 421 (Delhi High Court) H

A (iv) *Commissioner of Income Tax & Anr. v. Associated Electronics & Electricals Industries (Bangalore) (P) Ltd.*<sup>6</sup>

B (b) Without prejudice to the aforesaid contentions, his other submission was that if at all the capital gain tax was payable, liability to pay the same was that of the partnership firm and not the individual partners by virtue of Section 45(4), which reads as under:

C “45. **Capital gains.** – (1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 54, 54B, 54D, 54E, 54EA, 54EB, 54F, 54G and 54H, be chargeable to income-tax under the head “Capital gains”, and shall be deemed to be the income of the previous year in which the transfer took place.

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D (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 E 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.”

F 19. Second submission of the learned senior counsel for the assessee pertained to the payment of tax on the income which the business earned from April 01, 1994 till November 20, 1994. The learned counsel argued that as per the orders of the High Court in the winding up petition, 40% of this income was retained by AOP-3 as a tax component because of the reason that for business income of the earlier G years, after the dissolution, the same was taxed as an AOP. Therefore, the individual partners could not be taxed on the said business income in the year in question, as held in *M/s. Radhasoami Satsang, Saomi Bagh, Agra v. Commissioner of Income Tax*<sup>7</sup> and *Commissioner of Income*

<sup>6</sup> (2016) 130 DTR 0222 (Kar)

H <sup>7</sup> (1992) 1 SCC 659 : 193 ITR 321



*Tax v. Excel Industries Ltd.*<sup>8</sup> His related submission was that in any case this amount was not received by the assesseees as it was retained by AOP-3 and, therefore, tax was not payable by the assesseees. A

20. Coming to the first submission of the assesseees, it can be seen that it is founded on the premise that the assets of the firm were sold to AOP-3 as a going concern with further premise that it was a slump sale. B It is pointed out that the firm was doing business even after the winding up petition was filed and as a going concern, it was put to sale.

21. Mr. Radhakrishnan, learned senior counsel appearing for the Revenue, has refuted the aforesaid premise of the argument by submitting that though it was sold as a going concern, nevertheless, the assets were that of a dissolved firm as the firm had come to an end on December 06, 1987 by afflux of time. In order to establish this fact, learned counsel took us through the record, including the winding up petition which was filed in the High Court as well as the orders passed therein, which are relied upon by the assesseees themselves. C

22. After going through the records, we find that the Revenue has been able to substantiate the aforesaid submission. We have already noticed that the firm was dissolved on December 06, 1987 by afflux of time. This event happened as per the terms stipulated in the partnership deed itself. The necessity for filing the petition under the Companies Act arose because of differences between the erstwhile partners that had erupted, pertaining to the affairs of the firm. No doubt, in the said petition interim order dated November 05, 1988 was passed by the High Court permitting the group of persons (seven in number), having controlling interest in the firm, to continue the business. However, this was done as an interim arrangement till the completion of winding up proceedings. Pertinently, insofar as the firm is concerned, it did not carry on business thereafter as an existing firm. On the contrary, few ex-partners with controlling interest were allowed to continue the business activity in the interregnum as a stopgap arrangement. Another important fact which needs a mention is that, insofar as the firm is concerned, it did not file income tax returns after the date of dissolution. Obviously so, as it stood dissolved and was no more in existence. Precisely for this reason, the income that was generated from the business, after the dissolution, was assessed by the income tax authorities in the hands of such erstwhile partners as an AOP. It is this AOP which was filing the D E F G

<sup>8</sup> (2014) 13 SCC 459 : 358 ITR 295

A returns and getting the same assessed in that capacity and paying the income tax thereupon. Further, in the orders passed by the High Court from time to time in the said petition, insofar as the firm is concerned, it has always been described as '*the dissolved partnership firm*'. Thus, the assets which were sold ultimately on November 20, 1994 were of a dissolved partnership firm, though as a going concern.

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Once we straighten the factual position in the manner stated above, the whole legal edifice of the assessee's case crumbles down.

23. At this stage, we would like to clarify one more factual aspect. During the pendency of the winding up petition before the High Court, the High Court had passed various orders which included an order for valuation of the assets of the firm. This valuation was done to enable the Court to fix the reserve price for the purpose of *inter se* bidding between the erstwhile partners and/or association of erstwhile partners. The Chartered Accountants had done the valuation and submitted reports on the basis of which base price was fixed at ₹30 crores taking into account the value of various assets. These assets valued at ₹30 crores are sold for ₹92 crores. Thereafter, AOP-3, the successful bidder, deposited the amount of bid in respect of the share of nine other partners and a settlement was also prepared recording the value of the assets of the firm after deducting the liability of the said nine partners. The net value of the assets so arrived at and distributed among the nine partners.

24. What follows from the aforesaid facts is that the firm stood dissolved with effect from December 06, 1987; the company petition had to be filed by two partners in view of eruption of disputes among the partners; the business was carried on by the partners with controlling interest as an interim arrangement; the income was assessed in their hands as AOP and not in the hands of the firm which had already been dissolved; assets of the company were put to sale in accordance with Clause 16 of the Partnership Deed of a dissolved firm, though as a going concern; and outgoing partners (assessee herein) received their net share of the value of the assets of the firm out of the amount received by way of sale of the assets of the firm as per Clause 16 of the Partnership Deed.

On the aforesaid facts, it becomes clear that asset of the firm that was sold was the capital asset within the meaning of Section 2(14) of the Act. It is not even disputed. Once it is held to be the "capital asset",

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gain therefrom is to be treated as capital gain within the meaning of Section 45 of the Act. A

25. The assessee, however, are attempting to wriggle out from payment of capital gain tax on the ground that it was a “slump sale” within the meaning of Section 2(42C) of the Act and there was no mechanism at that time as to how the capital gain is to be computed in such circumstances, which was provided for the first time by Section 50B of the Act with effect from April 01, 2000. However, this argument fails in view of the fact that the assets were put to sale after their valuation. There was a specific and separate valuation for land as well as building and also machinery. Such valuation has to be treated as that of a partnership firm which had already stood dissolved. B  
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26. Section 2(42)C defines ‘slump sale’ and reads as under:

“ ‘slump sale’ means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. D

*Explanation 1.* – For the purposes of this clause, “undertaking” shall have the meaning assigned to it in *Explanation 1* to clause (19AA).

*Explanation 2.* – For the removal of doubts, it is hereby declared that the determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees shall not be regarded as assignment of values to individual assets or liabilities.” E  
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As per the aforesaid definition, sale in question could be treated as slump sale only if there was no value assigned to the individual assets and liabilities in such sale. This has obviously not happened. It is stated at the cost of repetition that not only value was assigned to individual assets, even the liabilities were taken care of when the amount of sale was apportioned among the outgoing partners, i.e. the assessee herein. G  
Once we hold that the sale in question was not slump sale, obviously Section 50B also does not get attracted as this section contains special provision for computation of capital gains in case of slump sale. As a *fortiorari*, the judgment in the case of *PNB Finance Limited* also would not apply. H

A           27. In the aforesaid scenario, when the Official Liquidator has distributed the amount among the nine partners, including the assessee herein, after deducting the liability of each of the partners, the High Court has rightly held that the amount received by them is the value of net asset of the firm which would attract capital gain. Scope of Section 45 of the Act was explained in *Commissioner of Income Tax, Faridabad v. Ghanshyam (HUF)*<sup>9</sup> and we would like to reproduce the following discussion from the said judgment:

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C           “16. The following conditions need to be satisfied for taxing a transaction as capital gains viz. the subject-matter must be a capital asset, the transaction must fall in the definition of “transfer”, there must be profit or loss called “capital gains” and that the taxpayer has claimed exemption in whole or in part by complying with legal provisions (like Section 54-F).

D           17. Section 45(1) of the 1961 Act speaks about capital gains arising out of “transfer” of a capital asset. The definition of the expression “transfer” is contained in Section 2(47) of the 1961 Act. It has very wide meaning. What is taxable under Section 45(1) of the 1961 Act is “profits and gains arising from a transfer of a capital asset” and the charge of income tax on the capital gains is a charge on the income of the previous year in which the transfer took place.

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F           18. Capital gain(s) is an artificial income. It is created by the 1961 Act. Profit(s) arising from transfer of capital asset is made chargeable to income tax under Section 45(1) of the 1961 Act. From the scheme of Section 45, it is clear that capital gains is not an income which accrues from day-to-day during a specific period but it arises at a fixed point of time, namely, on the date of the transfer. In short, Section 45 defines “capital gains”, it makes them chargeable to tax and it allots the appropriate year for such charge. It also enacts a deeming provision. Section 48 lays down the mode of computation of capital gains and deductions therefrom.”

G           In para 45 of the judgment, the Court also stated that capital gains under Section 45 of the Act are not income accruing from day to day. It

H           <sup>9</sup> (2009) 8 SCC 412

is deemed income which arises at a fixed point of time, viz. on the date of transfer. A

28. When we apply the said legal principle to the facts of the instant case, we find that the partnership firm had dissolved and thereafter winding up proceedings were taken up in the High Court. The result of those proceedings was to sell the assets of the firm and distribute the share thereof to the erstwhile partners. Thus, the 'transfer' of the assets triggered the provisions of Section 45 of the Act and making the capital gain subject to the payment of tax under the Act. B

29. Insofar as argument of the assesseees that tax, if at all, should have been demanded from the partnership firm is concerned, we may only state that on the facts of this case that may not be the situation where the firm had dissolved much before the transfer of the assets of the firm and this transfer took place few years after the dissolution, that too under the orders of the High Court with clear stipulation that proceeds thereof shall be distributed among the partners. Insofar as the firm is concerned, after the dissolution on December 06, 1987, it had not filed any return as the same had ceased to exist. Even in the interregnum, it is the AOP which had been filing the return of income earned during the said period. The High Court has touched upon this aspect in greater detail in para 30 of its judgment. Since we agree with the same, we reproduce below the discussion in the said para: C D E

"30. In view of the provisions of Section 45 it is clear that in the present case, the effect of the sale conducted by this court among partners and under Clause 16 of the said Partnership Deed, is that once the partnership is dissolved, the partners would become entitled to specific share in the assets of the firm which is proportionate to their share in sharing the profits of the firm and they are placed in the same position as the tenants in common and for the purpose of dissolution and u/s 47 of the Indian Partnership Act, 1932, it is clear that even after the dissolution of the firm, the authority of each partner to bind the firm and the other mutual rights and obligations of the partners continue notwithstanding the dissolution so far as may be necessary to wind up the affair of the firm and to complete transactions begun but unfinished at the time of the dissolution. F G

A Therefore, for realisation of the assets, discharging the liability of the firm and settling the accounts of the partners, etc., the firm will continue to exist despite the dissolution and not for any other purpose. The material on record in the instant case would clearly show that after dissolution of the firm on 06.12.1987, the firm has never filed any return and in view of the order of this court permitting the partners to carry on the business in the interest of employees, return was filed by AOP-13 consisting of erstwhile 13/12 partners for accounting profits and seeking depreciation in the assets of the firm and continued to do business in view of the order of this court that there was no agreement among the partners to continue the business during the pendency of the winding up proceedings. Further having regard to Clause 16 of the Partnership Deed of the dissolved firm, it is clear that the partners intended that the assets of the firm should not be sold to an outsider. It is well settled that every act of the partner would be binding on the firm and also the partners inter se and Clause 16 of the Partnership Deed which has been culled out supra clearly shows that if Partnership is dissolved, the going concern carried on under the name of the Firm MANGALORE GANESH BEEDI WORKS and all the trade marks used in course of the said business by the said firm and under which the business of the Partnership is carried on shall vest in and belong to the Partner who offers and pays or two or more Partners who jointly offer and pay the highest price therefor as a single group at a sale to be then held as among the Partners shall be entitled to bid. The other Partners shall execute and complete in favour of the purchasing Partner or Partners at his/her or their expense all such deed, instruments and applications and otherwise aid him/her or them for the registration his/her name or their names of all the said trade marks and do all such deed, acts and transactions as are incidental or necessary to the said transferee or assignee Partner or Partners. The final order passed by this court to wind up the affairs of the firm would clearly show that the property of the firm is purchased by the association of 3 partners

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who submitted their highest bid and that other partners had to given an undertaking that they may not interfere with the carrying on business which is vested in the name of MGBW and all the trademarks used in the course of said business and therefore it is clear that the appellants who are erstwhile partners were not successful bidders for continuation of business in the individual capacity of the MGBW and in view of Clause 16, all tangible and intangible assets vested with Association of 3 partners whose highest bid of Rs.92 crores was accepted and admittedly after the passing of the order of this court on 20.11.1994, all the appellants herein and other out-going partners have given requisite undertaking as per the order of this court and the MGBW as a going concern under the name and style MGBW and all trademarks used in the course of said business by the said firm and all tangible and intangible assets of the firm vested with the purchasers erstwhile 3 partners who paid the highest bid and the appellants have received consideration of the conveyance and their respective share in the sale of net assets of the firm after their undertaking that they cannot interfere with the business of MGBW which is vested with all assets in favour of 3 partners have received the value of their net asset which has been distributed by the Official Liquidator and AOP 3 who have purchased the business of the old firm, succeeded to it and constituted a new firm in the same name (vide order defendant (*sic* - dated) 14.06.1991 in the Company Petition) and therefore it is clear that the order passed by the Assessing Authority confirmed in the first appeal and by the Income Tax Appellate Tribunal (Special Bench) holding that the appellants as erstwhile partners are liable to pay capital gain on the amount received by them towards the value of their share in the net assets of the firm are liable for payment of capital gains u/s 45 of the Act. The said finding is justified and accordingly we answer the substantial question of law in favour of the Revenue and against the assessee.”

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30. In view of our aforesaid discussion, the arguments that valuation of goodwill was wrongly done may also not survive. In any case, we

A find that no such plea was taken by the assesseees in the High Court or before the Tribunal or lower authorities.

31. We now advert to the second argument.

B 32. It is argued that insofar as income of the firm in the Assessment Year in question is concerned, it could not be taxed at the hands of the assesseees. We find merit in this submission.

C 33. First, and pertinently, it is an admitted case that 40% of the said income was allowed by the High Court to be retained by the successful bidder (AOP-3) precisely for this very purpose. This 40% represented the tax which was to be paid on the income generated by the ongoing concern being run by the Association of Persons, as authorised by the High Court. Secondly, in the previous years, the Department had taxed the AOP and this procedure had to continue in the Assessment Year in question as well {See - *M/s. Radhasoami Satsang, Saomi Bagh, Agra and Excel Industries Ltd.*}

D From the judgment of the High Court, we find that this aspect has been dealt with very cursorily, without taking into consideration the aforesaid aspects highlighted by us. The entire discussion on this issue is contained in para 31, which reads as under:

E “31. The concurrent finding on question of fact that value of profit received during interregnum period for a period of 234 days is to be treated as revenue income having regard to the reasons assigned that said profit is calculated on the basis of notional profit calculated on two years average profit and from this average 40% was to be deducted and the net amount was to be paid, the finding is unassailable...”

F The aforesaid discussion of the High Court deals how the business income/revenue income is to be treated/calculated, but the question of taxability at the hands of the assesseees has not been touched upon at all.

G 34. The upshot of the aforesaid discussion would be to allow the appeals partly only to the extent that business income/revenue income in the Assessment Year in question is to be assessed at the hands of AOP-3, in terms of the orders of the High Court, as AOP-3 retained the tax amount from the consideration which was payable to the assesseees herein and it is AOP-3 which was supposed to file the return in that behalf and pay tax on the said revenue income.

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35. Insofar as the appeals preferred by the Revenue are concerned, they arise out of the protected assessment which was made at the hands of the partnership firm. As we have upheld the order of the Assessing Officer in respect of payment of capital gain tax by the assessee herein, these appeals are rendered otiose and are disposed of as such. A

36. There shall be no order as to costs. B

Divya Pandey

Appeals of assessee partly allowed.