

In the High Court of Judicature at Madras

Dated : 16.7.2019

Coram :

The Honourable Mr.Justice T.S.SIVAGNANAM

and

The Honourable Mrs.Justice V.BHAVANI SUBBAROYAN

Tax Case Appeal No.391 of 2019

The Principal Commissioner of
Income Tax, Central-2, Chennai-34

...Appellant

Vs

M/s.Ram Krishnan Kulwant Rai
Holdings Pvt. Ltd.,
NO.108, Nungambakkam High Road,
Chennai-34.

...Respondent

APPEAL under Section 260A of the Income Tax Act, 1961 against the order dated 29.10.2018 made in ITA.No.1047/Chny/2018 on the file of the Income Tax Appellate Tribunal, Chennai 'A' Bench for the assessment year 2009-10, against the order dated 11/01/2018 in ITA.NO.273/16-17 on the file of the Commissioner of Income Tax(Appeals)18 No.46, Mahatma Gandhi Road, Nungambakkam, Chennai-34 against the Assessment order dt.30/06/16 on the file of Assistant Commissioner of Income Tax Central Circle 2(3), Chennai-34 in PA/GIR NO.AAECR2215B.

For Appellant : Mr.T.R.Senthilkumar, SSC
For Respondent: Mr.R.Sivaraman

Judgment was delivered by T.S.SIVAGNANAM, J

We have heard Mr.T.R.Senthilkumar, learned Senior Standing Counsel for the appellant - Revenue and Mr.R.Sivaraman, learned counsel appearing for the respondent - assessee.

2. This appeal filed by the Revenue under Section 260A of the Income Tax Act, 1961 (for short, the Act) is directed against the order dated 29.10.2018 made in ITA.No.1047/Chny/2018 on the file of the Income Tax Appellate Tribunal, Chennai 'A' Bench (hereinafter called the Tribunal) for the assessment year 2009-10.

3. The Revenue has filed this appeal by raising the following substantial questions of law :

"i. Whether the Appellate Tribunal is correct in law in holding that there is no violation of the conditions stipulated in Section 47(xiii) of the Income Tax Act without taking cognizance of the fact that the partners of the erstwhile firm derived benefit other than allotment of shares by way of loan credits in their favour on conversion of the partnership firm into a private limited company ?

ii. Whether the Tribunal was correct in placing reliance on the Madras High Court's decision in the case of CADD Centre Vs. ACIT [reported in 383 ITR 258], when the vital distinguishing factor viz benefit derived by partners of erstwhile firm other than allotment of shares in the succeeding company is not available in the relied upon case ? And

iii. Whether the Tribunal was legally justified in holding that capital gains tax cannot be levied in the hands of the assessee company, which succeeded to the assets and liabilities of the partnership firm ?"

4. The issue, which falls for consideration, is as to whether there has been any violation of the conditions stipulated under Section 47(xiii) of the Act.

5. The assessee is a private limited company, which filed its return of income on 30.9.2009 admitting an income of Rs.12,44,401/-. Originally, the assessee was a partnership firm and it was converted into a private limited company under the Companies Act. The partnership firm revalued its assets on 30.11.2008 and in the revaluation, the value of the assets was increased to the extent of Rs.1,17,24,04,974/-, but the book value of the assets on date of revaluation was Rs.52,16,526/-.

6. Subsequently, the assessment was reopened and completed on 30.6.2016 under Sections 143(3) read with 147 of the Act. The Assessing Officer held that the total revalued value of the capital accounts of all the four partners stood at Rs.1,17,32,87,069.51 Ps, that the shares were allotted to the partners of the firm for a total amount of Rs.10,00,000/- and

that the balance of Rs.1,17,22,87,070/- was given as credit of loan to the partners of the erstwhile firm in the same proportion as their share capital of the firm. Thus, the Assessing officer held that this was a deviation stipulated under Section 47(xiii) of the Act for exemption from capital gains and therefore, made an addition of Rs.1,17,22,87,070/- towards short term capital gains and demanded tax thereon.

7. Aggrieved by the order passed by the Assessing Officer, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals)-18, Chennai [for brevity, the CIT(A)], who, by order dated 11.1.2018, dismissed the appeal. On further appeal, the Tribunal, by the impugned order, allowed the assessee's appeal and the Revenue is before us challenging the order passed by the Tribunal by raising the aforementioned substantial questions of law.

8. After hearing the parties, in our considered view, the CIT (A) did not take into consideration the specific ground raised by the assessee contending that the Assessing Officer erred in treating the registration of the partnership firm to a company under Part IX of the Companies Act, 1956 does not amount to a conversion of a partnership firm into a company as contemplated under Section 47(xiii) of the Act. The CIT(A) also did not take note of the fact that post conversion of the partnership firm into a company, the total balance in capital account of all the partners stood at Rs.1,17,32,87,070/-, that consequently, shares were allotted to the partners of the firm for a total amount of Rs.10 lakhs and that the balance of Rs.1,17,22,87,070/- was given as to the credit to the partners of the erstwhile firm in the same proportion as in the firm.

9. The assessee specifically stated that upon conversion of a firm into a joint stock company under the provisions of Part IX of the Companies Act, 1956, the assets and liabilities were vested into the company by virtue of law and that there was no transfer of assets. It was further contended that there was no dissolution of the firm or distribution of assets among partners, which is a condition precedent to tax the transaction under Section 45(4) of the Act. In support of their contention, the assessee referred to various decisions of the Tribunal and the High Courts.

10. However, the CIT(A) opined that the shares worth of Rs.10 lakhs were given as credit of loan to the partners of the erstwhile firm in the same proportion and that this has to be treated to fall foul of the condition stipulated in Section 47 (xiii) of the Act.

11. We find that the CIT(A) did not take into consideration the legal issue involved i.e. when a firm is succeeded by a company with no change either in the number of members or in the value of assets with no dissolution of the firm and no distribution of assets with change in legal status alone, whether there is a 'transfer' as contemplated under Sections 2

(47) and 45(4) of the Act. This issue was rightly decided by the Tribunal by taking into consideration the decision of a Division Bench of this Court in the case of CADD Centre Vs. ACIT [reported in (2016) 383 ITR 258], in which, the decision of a Division Bench of the Bombay High Court in the case of CIT Vs. Texspin Engineering and Manufacturing Works [reported in (2003) 263 ITR 345], was taken into consideration.

12. At this juncture, it will be worthwhile to extract the relevant portion in the decision in the case of CADD Centre, which reads as hereunder :

"The question is whether such vesting stands covered by the expression transfer by way of distribution in Section 45(4) of the Act. There is a difference between vesting of the property, in this case, in the Limited Company and distribution of the property. On vesting in the Limited Company under Part IX of the Companies Act, the properties vest in the company as they exist. On the other hand, distribution on dissolution presupposes division, realisation, encashment of assets and appropriation of the realised amount as per the priority like payment of taxes to the Government, BMC etc., payment to unsecured creditors etc. This difference is very important. This difference is amply brought out conceptually in the judgment of the Supreme Court in the case of Malabar Fisheries Co. Vs. CIT [1979] 120 ITR 49. In the present case, therefore, we are of the view that Section 45(4) is not attracted as the very first condition of transfer by way of distribution of capital assets is not satisfied. In the circumstances, the latter part of Section 45(4), which refers to computation of capital gains under Section 48 by treating fair market value of the asset on the date of transfer, does not arise."

13. The endeavor of Mr.T.R.Senthilkumar, learned Senior Standing Counsel before us is by laying emphasis on the fact that the shares worth of Rs.10 lakhs were given to the partners, that the remaining was given as credit of loan to the partners of the erstwhile firm in the same proportion as their share capital of the firm and that this is a deviation from the conditions stipulated under Section 47(xiii) of the Act.

14. In our considered view, the legal position having been well settled that when vesting takes place, it vests in the company as they exist. Therefore, unless and until the first condition of transfer by way of distribution of assets is satisfied, Section 45(4) of the Act will not be attracted.

Therefore, in the facts and circumstances of the case, we find that there is no transfer by way of distribution of assets.

15. Mr.T.R.Senthilkumar, learned Senior Standing Counsel for the Revenue would contend that the decision in the case of CADD Centre is distinguishable on facts, as the Court held that there was no distribution of assets, but only taking over of assets of the firm to the company.

16. However, the vital difference is that shares worth of Rs.10 lakhs alone were allotted and that the remaining was given as credit of loan to the partners of the erstwhile firm in the same proportion as their share capital of the firm. In our considered view, what is required to be considered is the effect of vesting as held in the case of Texspin Engineering and Manufacturing Works, which followed the decision of the Hon'ble Supreme Court in the case of Malabar Fisheries Co. Vs. CIT [reported in (1979) 120 ITR 49] and there can be no distribution of assets when a partnership firm vests in a company under Part IX of the Companies Act, 1956. Thus, we are of the view that the Tribunal rightly followed the decision in the case of CADD Centre.

17. For the above reasons, the above tax appeal filed by the Revenue is dismissed and the substantial questions of law are answered against the Revenue. No costs.

Sd/-

Assistant Registrar(CS V)

//True Copy//

Sub Assistant Registrar

To

1.The Income Tax Appellate Tribunal, Chennai 'A' Bench.

2.The Commissioner of Income Tax(Appeals)18
No.46, Mahatma Gandhi Road,
Nungambakkam, Chennai-34.

3.The Assistant Commissioner of Income Tax Central Circle2(3),
Nungambakkam,
Chennai-34.

+1cc to Mr.T.R.Senthil Kumar, Advocate sr.60560

+1cc to Mr.R.Sivaraman, Advocate sr.60878

TCA.No.391 of 2019

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