

PUNJAB AND HARYANA HIGH COURT

Messrs Kay Engineering Co

Vs

Commissioner of Income-Tax

Income Tax Reference No. 9 of 1968

(D.K. Mahajan and B.R. Tuli, JJ.)

10.12.1970

JUDGMENT

B.R. Tuli, J.

1. The Income Tax Appellate Tribunal, Delhi Bench 'C' has referred the following questions of law to this Court for opinion along with the statement of the case :-

1. Whether on the facts and circumstances of the case, distribution of assets among the partners in species on dissolution of the firm amounts to sale or transfer within the meaning of section 10 (2) (vib) of the Indian Income Tax Act, 1922/section 34(3)(b) of the Income Tax Act, 1961 ?

2. Whether in view of the provisions of section 10(2)(vic)(ii) of the Indian Income Tax Act, 1922/section 33(4) of the Income Tax Act, 1961, on the admitted facts in the circumstances of the case, one-half of the development rebate in respect of machinery and plant which fell to the share of the two partners A.R. Khosla and Adarsh Bala Khanna was rightly withdrawn by the I.T.O. in respect of the assessment years 1959-60 to 1963-64 ?

3. Whether in respect of the assessment year 1964-65 when the factory worked for the whole year, the I.T.O. was legally entitled to disallow development rebate for the year in question on the basis of subsequent events which took place after the close of the account year, viz., 31st March, 1964 ?

2. The relevant facts are that on April 1, 1959, a partnership firm styled as Messrs. Kay Engineering Co., Kapurthala, was formed to carry on the business of manufacture and sale of electrical accessories at Kapurthala. This partnership consisted of four partners, namely, Anant Ram Khosla 1/3rd, Smt. Adarsh Bala Khanna 1/6th, Shanti Swarup Khosla 1/3rd and Manmohan Swarup Khosla 1/6th. Anant Ram Khosla and Shanti Swarup Khosla are brothers, Smt. Adrash Bala Khanna is the daughter of Anant Ram Khosla while Manmohan Swarup Khosla is the one

of Shanti Swarup Khosla. Manmohan Swarup Khosla retired from the said partnership firm on June 9, 1961, and the firm was dissolved by mutual consent of the partners by a deed of dissolution executed on that date. From the 10th of June, 1961, a new firm was constituted under the same name with the following partners :-

1. Shanti Swarup Khosla 1/2.
2. Anant Ram Khosla 1/3.
3. Smt. Adrash Bala Khanna 1/6.

The partnership deed of the new firm was also executed on June 10, 1961. This firm was dissolved with effect from March 31, 1964, and the assets of the firm were divided in species amongst the partners by drawing lots with the assistance of a Chartered Accountant. One-half of the assets were taken by Anant Ram Khosla and his daughter Smt. Adarsh Bala Khanna while the other half was taken by Shanti Swarup Khosla. Anant Ram Khosla and his daughter Smt. Adarsh Bala Khanna formed a new partnership firm under the name and style of Ram Kay Engineering Co., under a deed dated April 1, 1964, and carried on the business of manufacture and sale of electrical accessories, as was being done by the previous firm, this new firm however, lasted only for six days and on April 7, 1964, all the assets of the firm Ram Kay Engineering Co., were taken over by a private company, named Ram Kay Engineering Company Private Limited, which was constituted by Anant Ram Khosla and his daughter Smt. Adarsh Bala Khanna, the only two shareholders. They were also the partners of Ram Kay Engineering Co. Shanti Swarup Khosla also constituted a private limited company with effect from April 22, 1964, and the assets taken over by him on dissolution of the firm Messrs Kay Engineering Company were transferred to the private company which he formed by the name of Ess Ess Khosla Engineering Company Private Limited. We are not, however, concerned with the private company of Shanti Swarup Khosla in this case.

3. The Income Tax Department had allowed development rebate under section 10(2)(vib) of the Indian Income Tax Act, 1922 (hereinafter called the 1922 Act) to the firm up to the assessment year 1961-62 and under section 33 of the Income Tax Act, Act 1961 (hereinafter called the 1961 Act), for the assessment years 1962-63 and 1963-64 and no development rebate was allowed for the assessment year 1964-65 on the ground that there was no use allowing that rebate first then withdrawing it under section 155(5) of the 1961 Act. During the assessment for the year 1964-65, the Income Tax Officer issued a notice under sections 154/155 of the 1961 Act to Messrs. Kay Engineering Co., to show cause why development rebate already allowed in respect of the five assessment years with effect from 1959-60 to 1963-64 be not withdrawn. The assessee filed objections to the notice but they were not accepted by the Income Tax Officer on the ground that the facts clearly showed that the "requirement that the firm must be succeeded by a company is not satisfied in this case". The assessee filed an appeal before the Assistant Appellate Commissioner but with no success. The further appeal to the Income Tax Appellate Tribunal met the same fate. The result was that for all the five years, the development rebate already allowed to the assessee was withdrawn by passing modified orders of assessment under section 155 of the 1961 Act.

4. The assessee, Messrs Kay Engineering Co., then filed six reference applications before the Tribunal which arose out of the consolidated order of the Tribunal and all those applications were

decided by one order and the questions of law set out above in the beginning of this judgment have been referred to this Court for opinion.

5. The first question that arises for determination is whether the division of the assets amongst the partners of the firm Messrs Kay Engineering Co., on dissolution amounted to transfer of those assets to the partners. In our opinion, the division of assets did not amount to transfer of those assets in view of the decision of their Lordships of the Supreme Court in *Commissioner of Income Tax, Gujarat v. Keshavlal Lallubhai Patel*¹, and *Commissioner of Income Tax, Madhya Pradesh, Nagpur and Bhandara v. Dewas Cine Corporation*². In the case of Keshavlal Lallubhai Patel, their Lordships held that the partition of joint Hindu family property was not "transfer" in the strict sense. The second case of Dewas Cine Corporation is more in point as it relates to a partnership firm and it is pertinent to note the relevant observations from the judgment of their Lordships. These observations from the judgment of their Lordships. These observations are as under :-

"Under the Partnership Act, 1932, property which is brought into the partnership by the partners when it is formed or which may be acquired in the course of the business becomes the property of the partnership and a partner is subject to any special agreement between the partners entitled upon dissolution to a share in the money representing the value of the property. When the two partners brought in the theatres of their respective ownership into the partnership, the theatres must be deemed to have become the property of the partnership. Under section 46 of the Partnership Act, 1932, on the dissolution of the firm every partner or his representative is entitled, as against all the other partners or their representatives, to have the property of the firm applied in payment of the debts and liabilities of the firm, and to have the surplus distributed among the partners or their representatives according to their rights. Section 48 of the Partnership Act provides for the mode of settlement of accounts between the partners. It prescribes the sequence in which the various outgoings are to be applied and the residue remaining is to be divided between the partners. The distribution of surplus is for the purpose of adjustment of the rights of the partners in the assets of the partnership : it does not amount to transfer of assets.

On the dissolution of the partnership, each theatre must be deemed to be returned to the original owner in satisfaction partially or wholly of his claim to a share in the residue of the assets after discharging the debts and other obligations. But thereby the theatres were not in law sold by the partnership to the individual partners in consideration of their respective shares in the residue. The expressions 'sale' and 'sold' are not defined in the Income Tax Act : those expressions are used in section 10(2)(vii) in their ordinary meaning. 'Sale', according to its ordinary meaning, is a transfer of property for a price, and adjustment of the rights of the partners in a dissolved firm is not a transfer, nor it is for a price."

6. It is thus clear that the development rebate could not be withdrawn on the plea that on the dissolution of the firm, Messrs Kay Engineering Co., the assets had been transferred.

The assets that came to the share of Anant Ram Khosla and his daughter on the dissolution of the firm, Messrs. Kay Engineering Co., on March 31, 1964, continued to be employed for the manufacture of electrical accessories as before which entitled them to development rebate. As long as the firm Ram Kay Engineering Company worked for six days, there was no question of withdrawing the development rebate already granted or not to allow that rebate for that period. What is stated on behalf of the respondent is that the transfer of the assets to the private company, named Ram Kay Engineering Company Private Limited, on April 7, 1964, amounted to transfer of the assets and that this transfer did not comply with the provisions of section 33(4) of the 1961 Act and, therefore, the Income Tax Officer was justified in withdrawing the development rebate that had already been allowed during the five assessment years. There is no merit in this submission. The firm Ram Kay Engineering Co., was immediately succeeded by the private company and all its assets and liabilities were taken over by it and all the shareholders of the private company were the partners of the previous firm and, therefore, all the ingredients specified in section 33(4) and "Explanation (ii) thereto are satisfied in the present case. The private company cannot be said to have succeeded to M/s. Kay Engineering Co., Kapurthala, which was dissolved on March 31, 1964, but it succeeded to Ram Kay Engineering Co., which had come into being on April 1, 1964, and continued upto April 6, 1961. It is the assets and liabilities of this firm that were taken over by Ram Kay Engineering Company Private Limited and, therefore, the development rebate already allowed could not be withdrawn. The learned counsel for the respondent, however, pointed out that there were three shareholders of the private company whereas there were only two partners of the firm Ram Kay Engineering Co., and for this submission he referred to the last page of the Memorandum of Association and the last page of the Articles of Association of Ram Kay Engineering Company Private Limited as printed on pages 121 and 128 of the paper book. We, however, find that there are only two shareholders mentioned on these two pages and not three. The name and description of Smt. Adarsh Bala has been extended against the two numerals 2 and 3 and the other entries on these pages clearly show that only Anant Ram Khosla and Smt. Adarash Bala Khanna were the two shareholders of the private company Ram Kay Engineering Company Private Limited.

7. For the reasons given above, all the three questions are answered in the negative that is, in favour of the assessee and against the department. There will be no order as to costs.

Reference answered.

1(1965) 55 I.T.R. 637

2(1968) 68 I.T.R. 240