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Amount received by partner on retirement from partnership firm is not taxable as capital gain

The Mumbai Bench of the Income-tax Appellate Tribunal (ITAT) rendered its decision that the amount received by a partner upon retirement from the partnership firm as his share in the assets of the partnership firm, is not taxable as capital gains, as the same does not qualify as transfer under section 2(47) of the Income-tax Act, 1961.

Background:

- The taxpayer¹ had entered into a partnership with five other individuals in the year 1992.

While the taxpayer and another individual were to bring in a certain sum of money as capital contribution into the firm, the other four individuals brought a parcel of land as their capital contribution towards the firm.

The sole objective of the partnership firm was to develop the plot introduced by the four individuals.

- Over the years, one of the partners died (whose share in the partnership vested with an existing partner) and another partner retired (whose share was transferred to the taxpayer).
- Thereafter, during the Financial Year (FY) 2008-09, corresponding to Assessment Year (AY) 2009-10, the existing partners (including the taxpayer) retired from the firm and four new partners were admitted into the partnership firm vide deed of admission-cum-retirement dated 4 April 2008 (Deed).
- Upon retirement, the taxpayer received certain consideration as his share in the assets of the firm as full and final settlement of his account in the firm. The taxpayer had credited the consideration under the head 'Exempt income and receipt' in the capital account and did not offer the same to tax.
- During audit proceedings, the Assessing Officer (AO) held that the amount received by the taxpayer was in consideration of transfer of right, title and interest in the properties of the partnership firm and was taxable as capital gain under section 45(1) of the Income-tax Act, 1961 (ITA) on the following grounds:
 - The Deed was signed only by the taxpayer and the new incoming partners and not by the other retiring partners;
 - The other retiring partners had sold their shares in the land in favour of one of the new partners and had offered the same to tax as long-term capital gains.

¹ DCIT v. Dr. Vithal V. Kamat (ITA No.3870/M/2018) (Mumbai ITAT)

The AO held that the said gain was a long-term capital gain and the cost of acquisition was taken as Nil, as the taxpayer had a debit balance in the firm.

- On appeal, the Commissioner of Income-tax (Appeals) [(CIT(A)] allowed the appeal of the taxpayer by holding that the compensation received by the taxpayer upon retirement from the partnership firm as his share in the assets of the partnership firm was not liable to tax as there was no transfer of assets involved.
- Aggrieved by the decision of the CIT(A), the Revenue filed an appeal with the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT:

- The ITAT took note of the following earlier cases:
 - The Supreme Court (SC) case² which affirmed the decision³ of the Gujarat High Court (HC), wherein it was held that any money received by the partner upon retirement from the partnership firm as his share in the assets of the partnership concern was not a consideration for transfer of his interest in the partnership to the continuing partners and there was no transfer within the meaning of section 2(47) of the ITA (relating to definition of transfer under the ITA).
 - The SC case⁴, wherein it was held that any amount paid to the partner upon his retirement towards his share in assets was not a transfer within the meaning of section 2(47) of the ITA and not liable to capital gain.
 - The SC case⁵, wherein it was held that where the taxpayer received on retirement from the firm a sum more than what was due towards his capital and profit, amount received was not taxable as capital gain as there was no transfer of any asset as contemplated in section 2(47) of the ITA.
- In view of the above, the ITAT held that the case of the taxpayer was squarely covered by the above-mentioned decisions of the SC and dismissed the appeal of the Revenue by upholding the decision of the CIT(A).
- Further, the ITAT found merit in the alternative plea taken by the taxpayer that if the computational provision of capital gain as provided under section 48 of the ITA broke down, then the charging provision as provided under section 45 of the ITA would also fail as held by SC in an earlier case⁶.

² ACIT v. Mohanbai Pamabhai [1987] 165 ITR 166 (SC)

³ Add. CIT v. Mohanbai Pamabhai [1973] 91 ITR 393 (Guj HC)

⁴ Tribhuvandas G. Patel v. CIT [1999] 236 ITR 515 (SC)

⁵ CIT v. R. Lingmallu Raghu Kumar [2002] 124 TAXMAN 127 (SC)

⁶ CIT vs. B.C. Srinivasa Setty [1981] (128 ITR 294) (SC)

Comment:

Taxability of partners' share received on retirement from partnership firm, has been a subject matter of litigation. This ruling reiterates the principle that amount received by partner on retirement from partnership firm, as his share in the assets of the partnership firm, is not taxable as capital gains, as the same is not covered within the definition of transfer under section 2(47) of the ITA.

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