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By

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Dear Readers,

Greetings for the season!

Hope all of you are observing the safety measures when moving to offices and out of home. The lockdown was partially lifted but I wish to remind that threat has completely eliminated. I pray that every one of us should be healthy and least effected.

August is an important month for SBS. We have completed 11 years on August 3rd, this year. On this occasion, I thank everyone who helped us to be in the current stage. I wish everyone would support in the unconditional way as supported till date.

In this edition, the final part on the GST side which deals with the vires of Rule 117 which prescribes the time limit for availment of transitional credit. Apart from the above, we have covered another important aspect dealing with taxation of partner/firm at the time of retirement, dissolution and contribution of asset to the firm. This is a two part series and I recommend everyone to read both the parts to drive home the point.

I am also glad to share that we have released our first concept book 'Decoding MLI'. The copy of the book can be accessed on our mobile application 'SBS Connect' and also available at **https://www.sbsandco.com/concept-book/document/decoding-mli**

I hope that you will have good time reading this edition and please do share your feedback. I will also urge clients to mail us topics or issues on which you want us to deliberate in our future editions, so that we can contribute to the same.

Thanking You,

Suresh Babu S
Founder & Chairman

DIRECT TAXATION

PARTNER VIS-A-VIS CAPITAL GAINS - PART I

Contributed by CA Suresh Babu S & CA Sri Harsha

The taxation when a personal asset is contributed as capital to a partnership firmand the taxation of amounts received when the partner retires from the firm or the firm dissolves is quite a complex one and no straight answers can be found. There are conflicting judgments on the said aspects and one has to carefully study between the lines to make a conscious decision as regards to taxability. In this article, we would like to dwell on the major judgments which have contributed to the resolution (or complexity)of issue.

Before proceeding to analyse and understand the relevant judgments, it is necessary to understand the central issues and let us proceed to frame the same:

Issue #1	When a firm pays certain amounts to the retiring partner, can it be said that there is a transfer from partner in favour of continuing partners?
Issue #2	When a firm allocates certain assets to retiring partner, can it be said that there is a transfer of capital asset by such firm to the retiring partner?
Issue #3	When a firm distributes capital assets at the time of dissolution, can it be said that there is a transfer of capital asset by such firm to the persons?
Issue #4	When a personal asset is being contributed as capital to a partnership firm in which the contributor becomes a partner, can it be said that there is a transfer of capital asset by such person to the firm?

Modus Operandi:

The above issues were dealt in two part series. Hence, we advise the reader to read the two parts in conjunction to drive home our view points. Let us proceed further.

The bare text of relevant provisions would take us nowhere to answer the above issues. It is important to understand the various judgments surrounding the above issues to conclude the taxability. Though there are no single answers or sacrosanct views in taxation laws, we shall try to cull out the guiding light from the various judgments delivered in this context. At the end of the article, we shall summarise the responses to the above central issues by adopting the rationale delivered by various judgements.

The judgments which are going to be discussed in this article relate to period prior and post insertion of Section 45(3) and Section 45(4).Hence, there will be occasions where the courts would be dealing to answer the issues before them without referring to the said sections, since as on the date of such judgements, the relevant sections were not available on the statute book. While reading this article, the said aspect has to be made note of. Further, the judgments were dealt issue and chronological wise. Now, let us proceed to deal with the major judgments which revolve around the central issues framed above.

Dissolution of Firm:

In the matter of Malabar Fisheries Co[1] - Supreme Court:

(Dissolution – Recovery of Development Rebate – Dissolution is Not Transfer)

The facts of Malabar Fisheries Co were that the firm was originally constituted on 1st April 1959 consisted of four partners and carried on six different businesses. The firm got dissolved on 31st March 1963 and under the deed of dissolution executed by and between the partners, the business of erstwhile firm were taken by certain partners and one the partner has received a sum of money in lieu of his respective share in the assets. The firm when was alive and kicking has purchased certain machineries and installed them and by virtue of such installation was entitled for the development rebate under Section 33 of ITA. On dissolution, the ITO[2] took the view that Section 34(3)(b) has kicked in since the machineries were sold or transferred by the firm to the partners within the period of 8 years and accordingly, he withdrew the development rebate and proceeded to tax the firm on such amounts. The firm contended that distribution of assets by virtue of dissolution does not amount to sale or transfer and accordingly there is no violation of conditions mentioned in Section 34(3)(b) to occasion the recovery of development rebate
.
The Tribunal placing reliance on Dewas Cine Corporation[3] held that there was no sale or transfer within the meaning of Section 34(3)(b) in a transaction involving the adjustment of rights of the partners of a dissolved firm. The Revenue preferred an appeal before the High Court, wherein the High Court stated that the order of Tribunal was erroneous, since it was based on the judgments of Supreme Court in the matter of Dewas Cine Corporation (supra) and Bankey Lal Vaidya's ,[4] which were given under the context of old income tax law, wherein the phrases 'sale' or 'transfer' have not been specifically defined and to be understood in the common parlance. However, after the introduction of new income tax law, the phrase 'transfer' has defined to include 'extinguishment' and 'relinquishment' and thereby, the firm extinguishing its right in the machineries amounted to 'transfer' and accordingly the development rebate allowed earlier becomes taxable.

The firm has appealed before the Supreme Court and pleaded that there is no change in law even after introduction of definition of 'transfer' to include extinguishment. The firm placed reliance on the judgment in the matter of R.M.Amin[5] , where in it was held there would not be no transfer of capital assets in the meaning of Section 2(47) where a shareholder received money representing his shares on the distribution of net assets of company in liquidation, that must be regarded as having received that money in satisfaction of the rights which belonged to him by virtue of his holding shares and that transaction did not amount to any sale, exchange or relinquishment of capital assets or extinguishment of capital assets.

[1] [1979] 120 ITR 049 (SC)
[2] Income Tax Officer
[3] [1968] 068 ITR 240 (SC)
[4] [1971] 079 ITR 594 (SC)
[5] [1977] 106 ITR 368 (SC)

The Supreme Court after hearing both the parties, stated that the question that has to be answered is, whether the distribution, division or allotment of assets of firm consequent to its dissolution amounts to transfer of assets within the meaning of the words 'otherwise transferred' occurring in Section 34(3)(b), when the meaning of 'transfer' is read in light of section 2(47). In simple words, ***the question is whether the dissolution of a firm extinguishes the firm's right in the assets of the partnership so as to constitute a transfer of assets under section 2(47)?***

The Supreme Court after placing reliance on Lindley on Partnership, Dewas Cine Corporation (supra) and Bankey Lal Vaiday (supra) has held that the position as regards to the nature of firm and its property in Indian law is similar to position in English law, being, that a partnership firm is not a distinct legal entity and the partnership property in law belongs to all the partners constituting the firm. The Court also referred the judgment of Bhagwanji Morarji Goculdas v. Alembic Chemical Works Co. Ltd[6] held that a partnership firm is not a distinct legal entity apart from the partners constituting it and equally in law the firm as such has no separate rights of its own in the partnership assets.

Hence, it is difficult to accept the contention that upon the dissolution of the firm's right in the partnership assets are extinguished, when the firm as such has no separate rights of its own in the partnership assets and accordingly upon the firm's dissolution, there would not be an occasion for extinguishment of assets in the hands of firm. The Court also stated that it is necessary that the sale or transfer of assets must be by the firm to a person and every dissolution must in point of time be anterior to the actual distribution, division or allotment of assets that take place after making up accounts and discharging the liabilities and debts due by firm. When the firm is dissolved, the firm ceases to exists and it cannot be said that distribution, division or allotment of assets is done by dissolved firm. In this sense, the court held that is no transfer of assets by the dissolved firm to any person. Accordingly, the court upheld the order of Tribunal.

Key Take-Aways:

The Supreme Court has opined that even after the introduction of definition of 'transfer' to include extinguishment in its ambit, the firm and partners being one and the same, it cannot be said that the firm has extinguished its rights in assets when it got dissolved, because it cannot extinguish rights which it does not have in first place. Accordingly, it held that there cannot be transfer of assets on dissolution of firm to the partners. The Supreme Court continued its reliance on its earlier judgments of Dewas Cine Corporation and Bankey Lal Vaidya and held so.

[6] AIR 1948 PC 100

Retirement of Partner:

In the matter of Mohanbhai Pamabhai [7] – Gujarat High Court (affirmed by Supreme Court [8]):

(Retirement – Settlement in Cash + Goodwill – Balance Settled as per Credit in Partners Account)

The facts involved herein were that the assessees and seven other partners carried on business in partnership in the firm name of Prajapati Tiles Company. The firm was floated on 13th January 1953 and certain disputes arose among the partners and as a result the assessees retired from the firm with effect from 18th February 1962, leaving the other seven as continuing partners of the firm. By virtue of deed of retirement deed, the outgoing partners were entitled to get their share in net assets of the firm and an additional amount towards goodwill. The deed also states that the said amounts were paid to outgoing partners in lieu of all their rights, interest and share in partnership firm and each of them voluntarily give up their right, title and interest in the firm.

The ITO took the view that the amount received by outgoing partners to the extent it included proportionate share in the value of goodwill represented capital gains chargeable to tax under Section 45 of ITA [9]. The assessees have contended that such amounts were not subject to capital gains on two grounds. One, the retirement is akin to dissolution and accordingly the said transaction is covered under Section 47(ii) and thereby not amounting to transfer. Two, the goodwill was a self-created asset which had cost nothing to the firm and its partners in terms of money and a transfer of it was, therefore, not within the ambit of charging provision contained in Section 45 and the proportionate share in value of goodwill received by each of assessee for transfer of his interest in goodwill is not taxable as capital gain. The Appellate Commissioner has rejected both the grounds confirming the order of ITO.

The Tribunal stated that the retirement is different from dissolution and accordingly rejected the first ground of assessee to take shelter under Section 47(ii). However, the Tribunal found reasoning with the second ground that since goodwill has no cost, the same cannot be subjected to tax. Apart from the above, the assessees have raised another plea before the High Court stating that what they have received is their share of goodwill which is akin to the share of the other assets they have received and accordingly no tax can be fastened on such amounts. The assessees have further stressed on their second ground dealing with cost of goodwill and stated that the objective of section 45 being taxing the gain, in absence of methodology to determine the cost of acquisition for goodwill, the tax authorities were trying to the gross receipt instead of gain. Hence, the levy has to be failed.

The High Court stated that the revenue's argument that when assessees retired from the firm, the interest in each of the assessee in partnership assets including the goodwill was extinguished and therefore amounts to 'transfer', though appears plausible, is fallacious in that it ignores the true nature of interest of partner in the firm and the legal consequences which flow when a partner retires.

[7] [1973] 091 ITR 393 (Guj)
[8] [1987] 165 ITR 166 (SC)
[9] Income Tax Act, 1961

The High Court referring to the decision of Supreme Court in the matter of Narayanappa v. Bhaskara Krishnappa[10] , which dealt with issue under registration act vis-à-vis partnership law, wherein it was held that whatever may be the character of property which is brought in by the partners when partnership is formed or which may be acquired in the course of business by firm, it becomes the property of the firm and what a partner is entitled to is his share of profits, if any, accruing to the firm from the realisation of property, and upon dissolution of partnership to a share in the money representing the value of property. The Supreme Court further held that during the subsistence of firm, however, no partner can deal with any portion of property as his own despite the fact the firm does not own the said properties nor can he assign his interest in a specific item of firm property to anyone and what he has only right to obtain such profits, if any fall, from time to time to his share and upon dissolution of the firm to a share in net assets.

The High Court then referred to the Supreme Court's decision in Dewas Cine Corporation (supra). The facts of the said matter were that two partners, each owing a cinema theatre, formed a partnership firm to carry on business of exhibition of films and they brought their respective theatres into the books of firm as its assets. The firm was in existence for some time, but thereafter, dissolved and it was agreed that the theatres should be returned to its original owners and in the books of the firm, the theatres were shown as taken over at the original price less depreciation allowed during the subsistence of firm. The revenue raised a contention that the firm has sold assets to the respective partners in consideration of their respective shares and difference between the price realised and the written down value should be included in the total income of the firm. The said contention was rejected by the Supreme Court stating that on dissolution of firm the only right of a partner is to have the property of the firm applied in payment of debts and liabilities of the firm and have the surplus distributed among the partners or their representatives according to their rights and this distribution of surplus is for the purpose of adjustment of rights of partners in the assets of firm and does not amount to transfer.

The High Court then made a reference to its own judgment in the matter of Velo Industries v. Collector, Bhavnagar[11] , where the court was dealing with an issue under Bombay Stamp Act, 1958 vis-à-vis retiring partner. The High Court was seized with determining whether a partner who retires from the firm and take his share in the notional sale of assets would be falling under the ambit of 'conveyance on sale' so as to liable for stamp duty. The full bench of High Court stated that such a transaction does not involve any element of sale of interest of a partner in partnership assets and accordingly no stamp duty is required to be paid. The High Court after referring to all the above decisions stated that it clearly establishes that the interest of partner in the partnership is not interest in any specific item of partnership property, but a right to obtain his share of profits from time to time during the subsistence of firm and on dissolution to get his value in share of net assets and therefore when a partner retires from a firm and the amount of his share in the net partnership assets in form of money, after deduction of liabilities and prior charges is determined on taking accounts on the footing of notional sale of partnership assets and given to him, what he receives is his share in the partnership and not any consideration for transfer of his interest in the partnership to the continuing partners. The High Court stated that it is true the definition of 'transfer' includes the relinquishment or extinguishment, but even in such sense, there is no transfer of interest in the partnership assets involved when a partner retires from partnership, it is merely only adjustment of

[10]AIR 1966 SC 1300
[11][1971] 080 ITR 291

rights and did not involve relinquishment or extinguishment of the interest in the partnership assets. Accordingly, held that the goodwill received cannot be said against transfer of assesses right in partnership firm and in absence of transfer happening in terms of section 2(47), there cannot be any tax under section 45.

The High Court further held that assuming that the above conclusion is wrong, and assuming that when a partner retries, the rights in the partnership firm gets extinguished and such a transaction amounts to 'transfer', even in such case, the amount received as goodwill shall be out of scope of section 45 because there is no consideration which is received by retiring partner for such assumed transfer. The Court stated thatthe entitlement of retiring partner is the net partnership assets after satisfaction of debts and liabilities and it is therefore not possible to predicate that a particular amount is received by retiring partner in respect of his share in a particular partnership asset or that a particular amount represents consideration received by retiring partner for his extinguishment of his interest in particular partnership asset and accordingly held that there was no transfer of interest of any of the assessees in the goodwill of the firm and no part of amount received by any of the assessee was assessable to capital gains.

Key Take-Aways:

The High Court after referring to various judgments of Supreme Court and following Dewas Cine Corporation and others has held that there does not exist any extinguishment or relinquishment of rights towards the firm by retiring partner and accordingly there cannot be a transfer in terms of Section 2(47). Even assuming that there is a transfer, there is no consideration accruing from such assumed transfer, since the what is the retiring partner realises is his share in net assets of the firm after satisfaction of liabilities and debts and such amounts cannot be said to be consideration for transfer of rights, if any exists. The retiring partner just works out his rights and accordingly such amount cannot be called as consideration for transfer. Incidentally, the court also dealt with aspect of cost of acquisition of goodwill and held that if there is no cost of acquisition for goodwill, the same would not be considered as failure of section 48 and consequently failure of section 45. If there is no cost of acquisition, the said parameter has to be taken as nil for the purposes of section 48 and accordingly proceed to arrive at capital gain but it would not be correct to say that there is a failure of valuation mechanism. However, this part of the judgment was overruled by Supreme Court in the matter of B C Srinivasa Setty[12] .

In the matter of Tribhuvandas G Patel[13] – Bombay High Court:

(Retirement–Adhoc Payment – Not on Footing of Notional Sale – Transfer – Retirement v. Dissolution)

The facts in this matter were that Tribhuvandas G Patel (assessee) was a partner of the firm M/s Kumar Engineering Works. He continued as partner in the said firm upto 31st August 1961, thereafter he retired. On 5th December 1960, the assessee has served on remaining partners a notice of his intention to dissolve the firm. The remaining partners opposed the same and the assessee has filed a suit for dissolution for the firm. However, there went certain discussions among the partners and accordingly an

[12][1981] 128 ITR 294
[13][1978] 115 ITR 095 (Bom)

out of court settlement was achieved among them. Vide such terms of settlement, the assessee in a whole was entitled for an amount of Rs 9 lakhs on occasion of such retirement. The settlement deed notes that Rs 1 lakh is paid as his share of profit for the broken period ended 31st August 1961, Rs 50,000 as his share of the value of goodwill and Rs 4.77 lakhs as his share in remaining assets of the firm (by appreciation in the value of assets). The other items received by assessee which were included in the total amount of Rs 9 lakhs are not material for the purposes of the consideration by the court.

In the above facts, the High Court was concerned with three important questions. The first one being that the assessee has received Rs 1 lakhs as share of his profits. However, the firm was also assessed for the same assessment year and accordingly the share of profit of assessee was arrived by the ITO as an amount greater than Rs 1 lakhs. The ITO has proceeded to tax such enhanced amount as share of profit in the hands of assessee. The assessee has objected for such assessment stating that when he has received Rs 1 lakhs, the ITO cannot bring into tax the enhanced amount (by virtue of conclusion of assessment of firm), which he has never received in the first place. The assessee placing reliance on the judgment of N M Raji [14], wherein it was held that only the real income is taxable and in the instant case that would be Rs 1 lakhs and not the enhanced income. However, the High Court distinguished the facts of the said judgment to the instant facts and held that the rationale delivered in N M Raji (supra) would not apply and accordingly the assessee was liable to be taxed on the enhanced income.

The second issue that the court was seized with was, whether the assessee was liable to pay tax on the sum of Rs 50,000 which was received as his share of value of goodwill. The assessee contended that the goodwill is not subjected to tax since the same was a self-generated asset and there was no cost associated for its development and consequently the levy would fail. The High Court placing reliance on their recent judgment in the matter of Home Industries and Co[15] , wherein it was held that goodwill not being a capital asset, there would not be any tax implications on its transfer and accordingly held that the same was also not subjected to tax in the hands of the assessee.

The third issue, the important among the lot, was, whether the sum of Rs 4,77,941/- or any part thereof which the assessee received on occasion of retirement is subjected to tax. The assessee contended that he has retired from the firm and accordingly there is no transfer as contemplated in section 2(47), when retirement takes place and there is no transfer of capital asset within the meaning of section 45, calling for the obligation provided therein. He placed reliance on the Supreme Court judgments in the matter of Dewas Cine Corporation (supra) and Bankey Lal Vaidya (supra) and also the decision of Gujarat High Court in Mohanbhai Pamabhai (supra) to buttress his view that retirement does not call for any obligation under section 45. He also in alternate contended that the aspect of retirement is akin to dissolution and accordingly, the said transaction, even assuming to be transfer, would be exempted from the purview of section 45 in light of section 47(ii) which provides that settlement in pursuance of dissolution does not amount to transfer. The assessee relied on the judgment of Addanki Narayanappa [16], wherein the Supreme Court made general observations treating the retirement and dissolution as one and the same.

[14][1949] 017 ITR 180 (Bom)
[15][1977] 107 ITR 609 (Bom
[16]AIR 1966 SC 1300)

The revenue contended that upon retirement from a firm the retiring partner transfers or assigns or releases his share or interest in the partnership and its assets to the continuing partners, who were permitted to use such partnership assets including the retiring partner's erstwhile interest therein for the purpose of carrying on partnership business and accordingly such transfer was subjected to tax. The revenue further contended that retirement and dissolution were two separate events and one cannot be read into another and accordingly the shelter provided under section 47(ii) cannot be applied for the cases of retirement, since the same was applicable only to the cases where firms were dissolved.

The High Court after listening to both the sides, framed the main question as what would be the real nature of the transaction when a partner retires from the partnership? Does the transaction amounts to relinquishment of his share or interest in the partnership in favour of continuing partners or does it stand on the same footing as adjustment of rights that results upon dissolution of firm?

The High Court stated that 'retirement' and 'dissolution' are separate events and cannot be read into each other. The reliance by the assessee on the judgment in the matter of Addanki Narayanappa (supra) was brushed away stating that the Supreme Court therein was not dealing with capital gains tax but on an aspect on registration requirement when a partner retires from the firm.

The High Court then summarised that, if a retiring partner while going out and while receiving what is due to him in respect of his share:

- may assign his interest by a deed or
- he may instead of assigning an interest, take the amount due to him from the firm and give a receipt for the money and acknowledge that he has no more claim on his co-partners.

The Court then stated that the former type of transactions will be regarded as sale or release or assignment of his interest by a deed attracting stamp duty, while the latter type of transaction would not. **In other words, the High Court stated that question whether the transaction would amount to assignment or release of his interest in favour of continuing partners would depend upon what particular mode of retirement is employed? If instead of quantifying his share by taking accounts on the footing of notional sale, parties agreed to pay a lump sum in consideration of the retiring partner assigning or relinquishing his share or right in partnership and its assets in favour of continuing partners, the transaction would amount to transfer within the meaning of section 2(47).**

Since the assessee in the instant case has assigned his rights and taken an amount without quantifying his share by taking accounts on footing of notional sale, there exists a transfer within meaning of section 2(47) and accordingly the High Court held such transaction as transfer and subjected to tax.

Key Take-Aways:

The Bombay High Court arrived at conclusion qua the third issue without critically analysing the Gujarat High Court's decision in the matter of Mohanbhai Pamabhai (supra). To this extent, the conclusion arrived may be regarded as incomplete, especially when the facts of Mohanbhai Pamabhai (supra) are directly on the point of retirement which was also the facts in the matter before High Court.

In the matter of H R Aslot[17] - Bombay High Court:

(Dissolution v. Retirement – Retirement – Followed Tribhuvandas G Patel – Taxable)

In this matter, the Bombay High Court is called upon to examine whether amounts paid as a consequence of retirement of partners amount to transfer and accordingly be subjected to capital gains. The facts were that assesse H R Aslot was a partner with a firm known as Automobile and Agricultural Industries Corporation. The firm consist of 8 partners. The terms of partnership deed provide that in case of any disputes among the partners, the disputes would be referred to arbitrator and would be settled accordingly. There were some disputes in 1959 and accordingly the matter was referred to the arbitrator. The sole arbitrator has passed an award in 1960 and in substance, the effect of the award was that the assessee and other partner would retire from the firm with effect from 1st January 1960 and the other partner would continue the firm. The retiring partners would continue the earlier firm in the original name or any other name. The continuing partners were asked to pay Rs 5.6 lakhs to retiring partners in satisfaction of their respective shares and interest in partnership and the capital effects and goodwill thereof. The retiring partners were allowed to retain certain offices and also allowed to engage in sale of certain kind of agreed products. In pursuance of the award, all the partners have entered a deed of dissolution by recording the terms of the award and accordingly dissolved. In light of the terms agreed, the assessee has received an amount of Rs 4,67,529/-. The amount standing to the credit of the assessee in the books of the firm as on 31st Oct 1959 was determined at Rs 2,33,535/-. The difference between the amount received by assessee and the credit to the capital account was treated as income by the ITO. An appeal was filed before Appellant Assistant Commissioner, who took the view that the excess amount received over and above the capital of the assessee was on account of his share of goodwill received in consideration of his relinquishing his rights to share the profits in future and, thereof the balance amount was chargeable to capital gains. On reference to Tribunal, it was held that there could not be any transfer by retiring partners to the continuing partners and transaction between the continuing partners and retiring partners was part and parcel of scheme of dissolution of the firm and by placing reliance on the Honourable Supreme Court judgment in the matter of Bankey Lal Vaidya (supra) held that there cannot be any transfer to attract capital gains tax.

The Revenue carried the matter to the High Court. The Court after referring to both the parties framed the question that whether what was brought by the award of arbitrator read with agreement entered consequent to the award, was a dissolution of partnership or that it brought about a mere retirement of two partners permitting the remaining partners to continue the business of partnership firm. The Court stated that though the agreement entered in consequence to the award is termed as 'deed of dissolution', what actually happened was retirement of two partners as against the dissolution as contended by assessee and agreed by Tribunal. The Court further stated on reading the other clauses of the agreement, it is evident that the firm continues and only the two partners has retired. Hence, this is a case of retirement and not case of dissolution. Since, this is a case of retirement, the Court held that judgment of Honourable Supreme Court in the matter of Bankey Lal Vaidya (supra) would not apply since the issue therein was dissolution of the firm. The Court after concluding that the said transaction is retirement has placed reliance on the judgment of Tribhuvandas G Patel (supra), wherein the Bombay High Court stated that in case of retirement, there exists transfer and accordingly depending upon the clauses of the deed and amounts received, the tax liability arises and stated that the said judgment

[17][1978] 115 ITR 255 (Bom)

equally applies to the facts of assessee. Since in the case, the deed of dissolution stated that the retiring partners have assigned and released all the rights in favour of the continuing partners, the Court stated that it cannot take a view differing with Tribhuvandas G Patel (supra). Accordingly, the Court held that assessee is subjected to capital gains tax.

Key Take-Aways:

The Bombay High Court by following its earlier judgment in Tribhuvandas G Patel has held that when a document is executed to assign interest in favour of continuing partners by retiring partner, there would be a transfer in terms of section 2(47) and accordingly taxable. Noting that the arbitrator award and deed of dissolution on holistic reading appears to be retirement of the partners and not dissolution as canvassed by assessees therein, stated the judgment of Supreme Court in Bankey Lal Vaidya does not apply since in that case the court is concerned with dissolution and not retirement. Since dissolution and retirement are different events, one cannot be read into another and accordingly held that the Bankey Lal Vaidya's rationale does not apply.

In the matter of L Raghu Kumar[18] – Andhra Pradesh High Court (affirmed by Supreme Court[19]):

(Retirement of Partner – No Transfer – Followed Mohanbhai Pamabhai)

The assessee herein in a karta of an HUF and partner in two firms. He has retired from both the firms with effective from 1st Jan 1971. On the date of retirement, his capital accounts were credited with a sum of Rs 46,500 more than the amount due to him towards his capital and profits and the firms from which the assessee has retired were carrying on business with the remaining partners. The ITO has assessed the amount received from the firm by the assesse as capital gain. The assessee has initially raised the contention that the said transaction is covered under Section 47(ii) and accordingly not a transfer. Later before the Appellate Tribunal, the assessee has placed reliance on the judgment of Mohanbhai Pamabhai (supra) to contend that there is no transfer when a partner retires from the firm.The Appellate Tribunal has accepted the contention of the assessee and his reliance on Mohanbhai Pamabhai (supra) and accordingly held there does not exists any tax obligation in the hands of retiring partner.

The Revenue has preferred an appeal before Andhra Pradesh High Court. The High Court after setting out the facts referred to the judgment of Supreme Court in the matter of Narayanappa v. Bhaskara Krishnappa (supra) and Gujarat High Court's decision in the matter of Mohanbhai Pamabhai (supra) has held that there would not be any transfer when a partner retires from the firm since what happens on retirement is only working of the rights among the partners and nothing more. The High Court rejected the contention of Revenue that the decision of Narayanappa v. Bhaskara Krishnappa (supra) cannot be applied to the current facts for the reason that the issue involved therein was requirement to obtain registration under Registration Act and not a question under provisions of ITA, by stating that the language employed in Registration Act and ITA is analogous and accordingly the reliance has to be survived.

[18][1983] 141 ITR 674
[19][2001] 247 ITR 801

The High Court then distinguished Revenue's reliance on judgments of Bombay High Court in the matter of Tribhuvandas G Patel (supra) and HR Aslot (supra). The High Court stated that both the above judgments were rendered in the context of the facts involved therein and recognised that the Bombay High Court has not followed the decision of Gujarat High Court in Mohanbhai Pamabhai (supra) and has not accepted the principals enunciated by Supreme Court, where it had equated retirement and dissolution. The High Court stated that they are unable to accept the view as proposed by Bombay High Court. The High Court concluded that merelybecause Section 47(ii) excludes the application of Section 45, in case of dissolution of firms on the ground that no transfer is involved, it cannot be implied that a transfer is involved in case of retirement. The converse or the opposite does not follow.

The said order of High Court is challenged by Revenue before Supreme Court. The Supreme Court by following the decision of Mohanbhai Pamabhai (supra) as affirmed by it, held that there is no occasion to interfere in the order passed by High Court and concluded against Revenue.

Key Take-Aways:

The Andhra Pradesh High Court though made a reference to the judgments of Bombay High Court in the matter of Tribhuvandas G Patel and HR Aslot, has not distinguished in true sense the ratio held therein. The High Court has not tried to examine the contents of retirement deed or whether the partner has received only his share in net assets or lumpsum amount.

In the matter of NA Mody[20] - Bombay High Court:

(Dissolution v. Retirement – Retirement – Followed Tribhuvandas G Patel & HR Aslot – Taxable)

The assessee herein is an advocate and solicitor. The assessee is partner of solicitor firm Little and Co and for acquiring an interest in the assets, goodwill and profits of the firm, paid an amount of Rs 40,680/-. Certain disputes have arisen between partners and a suit was instituted in Bombay High Court against the assessee by other partners for dissolution and accounts. Consequent to the institution of suit, consent terms were arrived and vide clause 3 of such terms, that all partners except the assessee are entitled to continue the firm as if there had been no dissolution of the firm. The assessee was mentioned as retired from the firm and the share and interest in partnership and all its assets, including goodwill and outstanding have been taken by the continuing partners and paid in full satisfaction of assessee excluding profits for the certain period is fixed at amount of Rs 71,900/- (Clause 8). The said amount is agreed to be paid over a period time in instalments. Further, for the work done by the assessee prior to its dissolution, an amount of Rs 40,600/- is agreed to be paid over a period of time (Clause 12). The terms also stipulate that the decree operates as assignment of share, right, title, interest, claim and demand of assessee in Little and Co and all its assets, including goodwill and outstanding favour of continuing partners in proportion to the respective share and interest in Little and Co and the assessee do have no claim or demand of any nature whatsoever against the firm or any of its partners.

[20][1986] 162 ITR 420

The assessee filed his return stating that amounts received from Little and Co under Clause 8 and 12 are not taxable. The ITO has rejected the said contention and held that the entire sum as taxable. The Appellate Assistant Commissioner held that amount taxable under clause 8 was Rs 31,220/- (Rs 71,900 – Rs 40,680/-) and the amount of Rs 40,600/- under Clause 12 should be taxed, but spread over different assessment years. The Tribunal confirmed the order of Appellate Assistant Commissioner.

The assessee argued before the High Court that the amounts received are not taxable because the same represents his interest in the partnership and no transfer has taken place. The High Court stated that the consent terms recorded reveals that the assessee has retired from the firm and there is no dissolution which has happened. In absence of any dissolution, the judgment of Honourable Supreme Court in Bankey Lal Vaiday (supra) does not apply and the matter has to be decided accordingly. Then the High Court made reference to the judgement of Tribhuvandas G Patel (supra) and held that since the consent terms indicate that the assessee has relinquished his rights and interest in the firm towards the continuing partners, the same shall be subjected to capital gains tax. The High Court further stated that the decision of Mohanbhai Pamabhai of Gujarat High Court is also considered while arriving the decision of Tribhuvandas G Patel (supra) and if the retiring partneris taking money instead of assigning his right to continuing partners, then the said transaction may not be called as transfer but in the instant case of assesse the same did not happen and accordingly held that such amount is subjected to tax.

Key Take-Aways:

The Bombay High Court by following its earlier judgment in Tribhuvandas G Patel has held that when a document is executed to assign interest in favour of continuing partners by retiring partner, there would be a transfer in terms of section 2(47) and accordingly taxable. Noting that reading of consent terms indicate there is retirement of the partner and not dissolution as canvassed by assessees therein, stated the judgment of Supreme Court in Bankey Lal Vaidya does not apply since in that case the court is concerned with dissolution and not retirement. Since dissolution and retirement are different events, one cannot be read into another and accordingly held that the Bankey Lal Vaidya's rationale does not apply. Further, also held that the decision of Mohanbhai Pamabhai by Gujarat High Court is applicable to the instant facts, but there the retiring partners took what stood to the credit of their capital account and acknowledged the same and has not entered any document to relinquish their rights in firm to the continuing partners, which is not the fact in the instant case and accordingly held that the judgement of Mohanbhai Pamabhai cannot be applied.

In the matter of Tribhuvandas G Patel [21] – Supreme Court

(Retirement of Partner – No Transfer – Reversed Bombay HC Judgment - Followed Mohanbhai Pamabhai)

The assessee has appealed against the order of Bombay High Court (read **'In the matter of Tribhuvandas G Patel – Bombay High Court')**, wherein it was held that receipt of amount on occasion of retirement not on basis of notional sale of assets would be subjected to capital gains tax in the hands of retiring partner, as he has relinquished his rights to the continuing partners.

[21] [1999] 236 ITR 515 (SC)

The Supreme Court by making reference to Sunil Siddharathbhai (supra) and Mohanbhai Pamabhai[22] (wherein the decision of Gujarat High Court was affirmed) held that on even where a partner retires and some amount is paid to him towards his share in the assets, it should not be treated as transfer since it falls under section 47(ii) and accordingly the matter is held against revenue and favourable to assesse.

Key Take -Aways:

However, an important observation herein in both the referred judgments namely Sunil Siddharathbhai (supra) and Mohanbhai Pamabhai (supra), there was no major discussion on whether the retirement falls under the purview of section 47(ii). The issues under such matters were different and the conclusions arrived are different. Hence, this particular judgment of Supreme Court has to be taken with appropriate caution. Since, this decision reverses the decision of Tribhuvandas G Patel (Bombay High Court), all such decisions which followed the above namely H R Aslot (supra) and N A Mody (supra) has to be re-looked and a judicious decision has to be taken.

In the matter of Shevantibhai C Mehta[23] – ITAT Pune

(Retirement – Transfer - Followed Tribhuvandas G Patel, HR Aslot & NA Mody – Taxable)

The facts of the matter was that assessee filed his return of income declaring a total income of Rs 26,813/- . Along with such return of income, a letter was filed by assessee stating that he has retired from the firm of M/s Mehta & Kakade Associates by a deed of retirement and he has received Rs 34,43,700/- on the said occasion. Since there is no transfer of capital assets from him to the firm, he was of the belief that said income is not subjected to capital gains. Further, he contended that in view of provisions of Section 45(4), such liability to capital gains, if any, arises in the hands of firm and not in case of partner. The Assessing Officer rejected the said contention and brough the said amounts under the tax. The Assessing Officer while rejecting stated that the provisions of Section 45(4) would apply only if there is allocation of assets by the firm to the partner and does not cover instances where consideration is paid for retaining the assets by the continuing partners. Further, the Assessing Officer taking support from the judgments of HR Aslot (supra) and NA Mody (supra) stated that the High Court therein has drawn a distinction between 'retirement' and 'dissolution' and held that Section 45(4) would apply only for dissolution and not otherwise. Since the instant case pertains to retirement and amounts paid to retiring partner also includes value towards appreciation of an immovable property and also payment being made is for foregoing the rights in the profits of the firm, their interest, title, the Assessing Officer has held that such amounts would be subjected to capital gains tax and does not fall under Section 45(4).

The assessee carried the matter to CIT (A), wherein he after referring to Clause 7 of retirement deed, the CIT (A) stated that there exists a relinquishment in favour of continuing partners and accordingly upheld the order of Assessing Officer following the judgment of NA Mody (supra). Against this order, assessee has reached the Tribunal.

[22][1987] 165 ITR 166 (SC)
[23]2003 (8) TMI 208 – ITAT Pune

The Tribunal after hearing both the parties, stated that the contention made by assessee that the judgment of Assessing Officer and CIT (A) is erroneous since the said orders have placed heavy reliance on NA Mody (supra). The assessee's contention that since the judgment of NA Mody (supra) relies on the judgments of Tribhuvandas G Patel (the Bombay High Court) (supra) and HR Aslot (supra) which were disapproved by Andhra Pradesh High Court in matter of L Raghu Kumar (supra), which was subsequently affirmed by Supreme Court, it would mean that the judgments of Tribhuvandas G Patel (supra) and HR Aslot (supra) gets overruled and therefore the judgement in NA Mody (supra) would be bad law and order passed by placing reliance on such bad law is erroneous.

The Tribunal observed that the Andhra Pradesh High Court in the matter of L Raghu Kumar has not disapproved the judgments of Tribhuvandas G Patel (supra) and HR Aslot (supra) but stated that the same are based on facts. The Tribunal stated that the Andhra Pradesh High Court disagreed with the view that Bombay High Court took in Tribhuvandas G Patel (supra) that dissolution and retirement are separate aspects. The Tribunal stated that Andhra Pradesh High Court by placing reliance on Supreme Court judgment in Narayanappa v. Bhaskara Krishnappa (supra) and Gujarat High Court in Mohanbhai Pamabhai (supra) has held that retirement and dissolution are one and the same and accordingly differed with Bombay High Court's judgment.

The Tribunal then placing reliance on Delhi High Court judgment in matter of Bishan Lal Kanodia[24] , wherein it was held that since the judgment of Supreme Court in Narayanappa v. Bhaskara Krishnappa (supra) was not dealing with issue under capital gains but under Registration Act, the equating of retirement and dissolution as done for Registration Act cannot be applied for the purposes of Capital Gains, supported the judgment of Tribhuvandas G Patel (supra) and rejected the contention that said judgment got overruled by affirmation of Andhra Pradesh High Court's judgment in matter of L Raghu Kumar (supra).

The Tribunal stated that the reliance of assessee on Mohanbhai Pamabhai (supra) was distinguished in the matter of NA Mody (supra), wherein it was held that in facts of Mohanbhai Pamabhai (supra) the distribution happened on basis of notional sale and since the said facts do not appear in NA Mody (supra), the court therein stated that ratio of Mohanbhai Pamabhai does not apply. Similarly, the Tribunal held that since facts in the current case are different from Mohanbhai Pamabhai (supra), the said ratio does not apply to assessee and accordingly the reliance is misplaced.

The Tribunal after referring to various judgments concluded that the distinction between retirement and dissolution is irrelevant after removal of Section 47(ii) and insertion of Section 45(4) and stated that the ratio as delivered by Bombay High Court in NA Mody (supra) that the mode of retirement would have an effect on taxability of capital gains is still relevant, since there is no direct disapproval of such ratio by Andhra Pradesh High Court or subsequent affirmation by Supreme Court in L Raghu Kumar. The Tribunal further stated that said ratio on the contrary is blessed by Delhi High Court in Bishan Lal Kanodia (supra).
The Tribunal then summarised the legal position as under:

[24] AIR 1966 SC 1300

a. Retirement of a partner could take either of two forms and the question whether the transaction would amount to an assignment or release of his interest in favour of the continuing partners or not would depend upon what particular mode of retirement was employed.

b. If, instead of quantifying his share by taking accounts on footing of notional sale, parties agree to pay a lumpsum in consideration of the retiring partner assigning or relinquishing his share or right in the partnership and its assets in favour of continuing partners, the transaction would amount to a transfer within the meaning of section 2(47).

c. A retiring partner while going out and receiving what is due to him in respect of his share might assign his interest by a deed or he might, instead of assigning his interest, take the amount due to him from the firm and give a receipt for the money and acknowledge that he has no claims on his co-partners.

d. If the retiring partner assigns his interest, then the same would be transfer and instead of assigning takes money and gives claim that he has no claims on co-partners, then the same would not be transfer.

Key Take -Aways:

The Tribunal has followed the view enunciated by Bombay High Court in NA Mody (supra) and stated that if an adhoc/lumpsum amount is paid to retiring partner, then such transaction would amount to transfer. Also, if he only states that he does not have any claims on co-partners and receives money and acknowledges thereof, then the said transaction could not be called as transfer. If he assigns his interest or rights to continuing partners and take an amount, then such transaction would be called as transfer.

In the matter of AN Naik Associates & Others[25] – Bombay High Court

(Family Settlement – Allocation of Assets on Retirement - Transfer – 45(4) also covers 'retirement')

The facts of the matter was that by virtue of memorandum of family settlement, it is agreed between the parties thereto, that business of six firms would be distributed in terms of the family settlement as the parties desired that various matters concerning the business and assets thereto be divided separately and partitioned. Under the terms and conditions of the settlement, it was set out that the assets which are proposed to be divided in partition under family settlement are held by the firms and individual partners. With reference to the firms, the manner in which the firms were to be reconstituted by retirement and admission of new partners was also set out. It is also provided that such of those assets or liabilities belonging to or due from any of firms allotted to parties thereto in the schedule annexed to the family settlement shall be transferred or assigned irrevocably and possession made over and all such documents, deeds, declarations, affidavits, petitions, letters and alike as are reasonably required by the party entitled to such transfer would be effected.

[25][2004] 265 ITR 346 (Bom)

In the above facts and consequent to family settlement, the subsequent deeds of retirement of partnership were executed, which formed the subject matter for the dispute before the High Court. The tax authorities have contended that the allocation of assets to retiring partner would constitute a transfer in hands of the firm and accordingly taxable under Section 45(4). The assessee contended that Section 45(4) deals with only dissolution and not retirement and accordingly allocation of assets to retiring partners is not covered therein and the judgments of Supreme Court in Malabar Fisheries Co (supra) and others will continue to hold the ground even after introduction of Section 45(4) with effect from 01st April 1988. The assessees further contended that the phrase 'otherwise' used in Section 45(4) covers only cases which are similar to dissolution like deemed dissolution but does not intend to cover retirement. They have also contended that the retirement was carried by virtue of a family settlement and accordingly such family settlement would not result in transfer. The Assessing Officer rejected the above contention by stating that the firm was a device used to evade tax and the phrase 'otherwise' used in Section 45(4) covers retirement and accordingly held the assessee firm as taxable. The assessee approached the Commissioner (Appeals) who has rejected order of Assessing Officer. On subsequent appeal by Revenue, the Tribunal has held that the expression 'otherwise' has to be read ejusdem generis and would contemplate situations like deemed dissolution and consequently held that tax on capital gains was not chargeable, since on facts, the business continued and there was no dissolution to attract the obligation under section 45(4).

The Revenue further carried on the appeal before the High Court. The Court after setting the facts stated that the said question has to be interpreted based on the jurisprudence available post insertion of section 45(3) and section 45(4). The Court stated that prior to the above insertions, it was understood the there is no distinction between partners and firm and accordingly the transactions between them cannot be said to fall under the ambit of transfer to attract any obligation under capital gains tax. The legislature by noticing that the firms were used to avoid taxes by taking the shelter of general principals of partnership, has inserted the section 45(3) to state that whenever a partner converts his personal asset to partnership asset, the said transaction falls under the definition of 'transfer' and accordingly tax has to be paid in terms of section 45(3). It is submitted that the subject amendment of section 45 by insertion of sub-section (3) was to specifically overcome the judgment of Sunil Siddharathbhai (supra), wherein it was held that there exists a transfer when personal asset is converted to firm asset but in absence of mode of determination of consideration, the levy would fail. The Court stated, now by insertion of section 45(3), the said transaction is taxable and the consideration would be the amount recorded by the firm in its books.

In the same way, when a firm is dissolved/partner is retired and assets were allotted to the partners, the Supreme Court took the view that the same is working out the rights of the partners and there cannot be any transfer in such a situation to attract tax. It is submitted that this was the consistent view held by Supreme Court when it comes to transactions between firm/partner either at the time of retirement or dissolution. It is submitted that even though the Bombay High Court has taken different view the same was reversed by the Supreme Court in Tribhuvan Das G Patel (Read - In the matter of Tribhuvandas G Patel – Supreme Court) following Mohanbhai Pamabhai (supra) and Sunil Siddharathbhai (supra).

The High Court stated that the term 'otherwise' has to be interpreted keeping the intention behind the introduction of section 45(4) by the legislature. If the term 'otherwise' has to be interpreted only to mean dissolution and deemed dissolution, the entire reason why the subject section has been introduced gets otiose and accordingly held that the allocation of assets on retirement is also covered under the ambit of section 45(4). The Court stated that if the object of the Act is seen and the mischief it seeks to avoid, it would be clear that the intention of Parliament was to bring into the tax net transactions whereby assets were brought into a firm or taken out of firm.

The Court held that the expression 'otherwise' has not to be read ejusdem generis with expression 'dissolution of a firm or body or association of persons' but has to be read with words 'transfer of capital asset' by way of distribution of capital assets. If such an interpretation is taken, it becomes clear that even when the firm is in existence and there is a transfer of capital assets it comes within the expression 'otherwise' as the object of amendment was to remove loophole which existed whereby capital gains tax was not chargeable. The High Court in conclusion stated that the contention of the assessee that the amendment has happened only in section 45 but no similar amendment was carried in definition of transfer under section 2(47) was brushed aside stating that definition of transfer was an inclusive one.

Key Take -Aways:

This can be considered as one of the landmark judgments for the reason that the phrase 'otherwise' appearing in the Section 45(4) has been interpreted to cover the retirement of partner from the firm as against the plain interpretation of Section 45(4) which covers dissolution. The Court stated that if the intention of the legislature is kept in mind and then the provisions of Section 45(4) are interpreted, it is evident that the said section covers retirement also.It is important to note that the Court in this case, is considering, whether allocation of assets on retirement of a partner is covered under the ambit of Section 45(4) and not whether there is any transfer from partner to firm against the consideration received by the partner from the firm on his retirement.

In the matter of Sudhakar M Shetty[26] – ITAT Mumbai:

(Retirement – Transfer - Followed Tribhuvandas G Patel, HR Aslot & NA Mody – Taxable)

The facts of the matter was that the assessee along with another individual has entered a partnership agreement to develop a property to be known as Unity Compound in Mumbai. The firm was named as DS Corporation and it was decided that among assessee and the other partner to contribute the money required for the development of property in a specified percentage and profit sharing ratios were also agreed upon. A deed of admission cum reconstitution was made and accordingly the wife of assessee has been admitted into the firm. The firm has purchased the subject property for Rs 6.5 Crores. Post purchase of property, another deed of admission cum reconstitution was made and two partners were further admitted and profit sharing ration was re-distributed.

[26]2010 (9) TMI 746 – ITAT Mumbai | [2011] 130 ITD 197 (ITAT [Mum])

Post such admission, the firm has applied to tourism development corporation for approval for construction of five star hotel in the said property. The corporation have granted the approval. Post to such, the assessee's wife for various reasons decided to retire. A registered valuer is appointed for valuation of the property and accordingly the property was revalued now at Rs 193 Crores (approx.). A retirement-cum-admission was made and the assesses 's wife got retired and four partners were admitted. Prior to retirement of assessee's wife, the profit and loss account was drawn and profits arising on revaluation of property was appropriated to the capital account of partners of the firm as per their profit sharing ratio. Post her retirement, the assessee also retired from the firm and was paid the sum which was standing to credit of his account.

The Assessing Officer was of the belief that it was the case where instead of quantifying the assessee's share by taking accounts on the footing of the notional sale, parties agreed to pay a lump sum in consideration of retiring partner assigning or relinquishing his share or right in the partnership and its assets in favour of continuing partners. The capital account was artificially increased just to ensure that the retiring partner is paid consideration standing to credit of his capital account. The matter ultimately went to Tribunal and after setting out the facts and hearing the parties, the Tribunal held as under.

The Revenue contended that on reading of the retirement deed, it is evident that there is an extinguishment of the retiring partners rights on assignment of the retiring partners over the firm and its assets. Revenue contended that the mode of retirement in the instant case is similar to the retirement in case of Tribhuvandas G Patel (supra), HR Aslot (supra) and NA Mody (supra) and stated that following such judgements, the retirement is subjected to tax. The Tribunal stated that in the case of assessee, the clauses in retirement deed do convey interest in immovable property and further refers to the fact that the assessee will have any interest over the assets of the firm. The Tribunal thus stated that it was a case of lump sum payment in consideration of the retiring partner assigning or relinquishing his share or right in the partnership and its assets in favour of continuing partners and accordingly followed the decisions of Bombay High Court in Tribhuvandas G Patel (supra) and other judgments which followed them.

Key Take -Aways:

The Tribunal held that profit arising from revaluation of immovable property and sharing the same among the partners in their profit sharing ratio and taking the same amount at the time of retirement would amount to transfer since the same would be in the nature of lumpsum consideration. The Tribunal followed the judgments of Bombay High Court and Tribunal judgment in Shevantibhai C Mehta to hold that there exists a transfer and accordingly taxable.

In the matter of Savitri Kadur[27] – ITAT Bangalore:

(Retirement – Transfer - Followed Tribhuvandas G Patel, HR Aslot & NA Mody – Taxable)

The facts of the instant case was that assessee was a partner in a firm. The firm has admitted one more partner. Post such admission, the assessee has retired from the firm. On his retirement, she was paid an amount of Rs 3,39,50,000/-. Of the said amount, Rs 2,77,88,200/- was lying as credit in her capital account. The said balance is arrived after considering the opening balance, profits for the year, interest on her capital and profits arising on revaluation of land and building amounting to Rs 53,26,462/- and Rs 9,24,650/- and after reducing her drawings and other payments. The Assessing Officer held that the difference between Rs 3,39,50,000/- and Rs 2,77,88,200/- amounting to Rs 61,61,800/- was taxable under capital gains.

The matter was then taken to the CIT (A) by the assessee, wherein the later stated that the difference amounting to Rs 61,61,800/- is nothing but goodwill and the same is not taxable. The assessee placed reliance on the judgment of Karnataka High Court in Dynamic Enterprises [28]. The CIT (A), however following the decision of Bombay High Court in AN Naik & Associates (supra) held that the provisions of Section 45(4) also include instance of retirement and accordingly held that the said amounts were taxable.

The assessee has preferred an appeal before the Tribunal. The Tribunal stated that the amendments in Section 45 by way of insertion of Section 45(3) and (4) have tried to eliminate the strategies adopted by partners and firms to avoid payment of tax. The Tribunal further stated that decision of AN Naik (supra), wherein it was held that retirement also is covered under the ambit of Section 45(4), in a way puts to end to tax abuse.

The Tribunal also stated that when a partner retires and retiring partner is paid for relinquishing all his rights, interest in firm as under:

a. On the basis of amount lying in his/her capital account
b. On the basis of amount lying in his/her capital account + additional amount
c. Lumpsum amount with no reference to amount lying in his/her capital account

The Tribunal stated in situation 'a', there is no doubt that the judgment of Supreme Court in Mohanbhai Pamabhai (supra) and accordingly there would not be any tax. The Tribunal also held that even such credit in capital account also includes amount arising on account of revaluation, there should not make the transaction taxable. For instances vide 'b' and 'c', the Tribunal held that the same would be taxable following Tribhuvandas G Patel (supra), HR Aslot (supra) and NA Mody (supra). The Tribunal set aside the aspect of reversal of decision of Tribhuvandas G Patel at Supreme Court stating that the decision was rendered when Section 47(ii) was in existence and now that such section is not available, the reversal does not impact in anyway. The Tribunal accordingly held that whether the retirement of partner would result in transfer or not depends upon the mode employed as held in Tribhuvandas G Patel (supra) and NA Mody (supra). The Tribunal also referred to judgement of Shevantibhai Mehta (supra) and Sudhakar M Shetty (supra) and held that taxability of retiring partner would depend upon so many situations. Finally,

[27] 2019 (7) TMI 593 – ITAT Bangalore
[28] [2013] 359 ITR 83 – Karnataka High Court

the Tribunal held that the books of accounts and retirement deed nowhere makes a reference to goodwill as Rs 61,61,800/- but makes only reference to Rs 38,38,200/-, the balance Rs 23,23,600/- was held taxable stating that said instance falls under 'b' above.

Key Take -Aways:

The Tribunal though followed Tribhuvandas G Patel (supra) and NA Mody (supra) has held that the goodwill on revaluation of assets which stands to the credit of the capital account would not be subjected to tax. The Tribunal stating that since assessee has retired more than what is there is in there capital account would be subjected to tax.

Snapshot of Judgments:

Judgment	Forum	Aspect	F	Period	Mode	Cash	Goodwill	Rev Profit	Deed	Approval by SC
Mohanbhai Pamabhai	Guj HC	Retirement	A	Prior	Capital	Y	Y	-	Y	Y
Tribhuvandas G Patel	Bom HC	Retirement	R	Prior	Lumpsum	Y	Y	Y	Y	N
HR Aslot	Bom HC	Retirement	R	Prior	Lumpsum	Y	Y	-	Y	-
L Raghu Kumar	AP HC	Retirement	A	Prior	Capital	Y	-	-	Y	Y
NA Mody	Bom HC	Retirement	R	Prior	Lumpsum	Y	Y	-	Y	-
Shevanthibhai C Mehta	ITAT Pune	Retirement	R	Post	Lumpsum	-	-	-	Y	-
AN Naik	Bom HC	Retirement	R	Post	Assets	-	-	-	Y	-
Sudhakar M Shetty	ITAT Mumbai	Retirement	R	Post	Lumpsum	Y	-	Y	Y	-
Savitri Kadur	ITAT Bang	Retirement	A & R	Post	Lumpsum	Y	Y	Y	Y	-

Judgment	Forum	Aspect	F	J1	J2	J3	J4	J5	J6	J7	J8	J9	J10
Mohanbhai Pamabhai	Guj HC	Retirement	A	F	F	-	-	-	-	-	-	-	-
Tribhuvandas G Patel	Bom HC	Retirement	R	NF	NF	NF	-	-	-	-	-	-	-
HR Aslot	Bom HC	Retirement	R	NF	NF	NF	F	-	-	-	-	-	-
L Raghu Kumar	AP HC	Retirement	A	F	F	F	NF	NF	-	-	-	-	-
NA Mody	Bom HC	Retirement	R	-	NF	NF	F	F	-	-	-	-	-
Shevanthibhai C Mehta	ITAT Pune	Retirement	R	-	-	NF	F	F	NF	F	-	-	-
AN Naik	Bom HC	Retirement	R	-	-	-	-	-	-	-	-	-	-
Sudhakar M Shetty	ITAT Mumbai	Retirement	R	-	-	NF	F	F	NF	F	F	F	-
Savitri Kadur	ITAT Bang	Retirement	A & R	-	-	D	F	F	NF	F	NF	F	F

Legends:

Acronym	Detailed
ITAT	Income Tax Appellate Tribunal
SC	Supreme Court
Y	Yes
N	No
F	Favourable
A	Assessee
R	Revenue
Prior	Prior to 1988
Post	Post to 1988
Capital	Credit lying in his/her capital account at the time of retirement
Lumpsum	Amount paid to retiring partner without reference to Capital
F	Followed
NF	Not Followed
D	Distinguished
J1	Dewas Cine Corporation
J2	Bankey Lal Vaidya
J3	Mohanbhai Pamabhai
J4	Tribhuvandas G Patel
J5	HR Aslot
J6	L Raghu Kumar
J7	NA Mody
J8	Shevanthibhai C Mehta
J9	AN Naik & Associates
J10	Sudhakar M Shetty

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GST

THE VIRES, RIGHTS AND RETROSPECTIVITY - TRANSITIONAL CREDIT - PART III

Contributed by CA Sri Harsha & CA Manindar

(This article is Part III in a three part series. For the previous part, please refer to our previous edition of our journal)

Introduction:

Claim of credit accumulated in the returns of erstwhile regime under GST[1] regime by filing TRAN-01 return i.e. transitional credit is subject to vexatious litigation as many of the taxpayers failed to meet the due date prescribed in Rule 117[2] . The reasons for not meeting the due date are due to in efficiency of GST Portal[3] , taxpayers are not vigilant of the time limit or due to confusion and chaos that was prevailing at the time when this new tax was introduced. A large number of writ petitions were filed between various High Courts expressing the inability to meet the due dates mainly due to inefficiency of GST Portal and accordingly requesting the courts to permit the filing of these returns.

Based on various courts directions, Central Government admitted the inefficiency of GST Portal and sub-rule (1A) has been introduced in Rule 117 through which the due date has been extended to those categories of taxpayers who could produce evidence of their attempt to file the TRAN-01 return within due date but were unsuccessful due to technical difficulties of GST Portal. But the plight of those taxpayers who could not gather evidence relating to their attempt to file the TRAN-01 return was not addressed.

In this backdrop, the vires of Rule 117 which imposed the time limit for filing TRAN-01 was challenged on the ground that no such power was conferred under Section 140 [4]of CT Act[5] and is taking away the vested right over the accumulated transitional credit of previous regime. The High Courts have taken different stand on this issue and some of them ruled in favour of taxpayers while others were in favour of Revenue. The Finance Act, 2020 made retrospective amendment[6] to read timelines intoS ection 140 in order to nullify those judgements that were ruled in favour of the taxpayer.

In the earlier part, we have dealt with the vires of Rule 117 and in this part, we shall deal with the vested rights of Tran credit and retrospectivity of the amendment to Section 140 along with our comments. Let us proceed further.

[1]Goods and Services Tax
[2]Central Goods and Services Tax Rules, 2017
[3]www.gst.gov.in
[4]Section 140 deals with 'transitional arrangements for input tax credit'
[5]Central Goods and Services Tax Act, 2017
[6]The amendment is made effective vide Notification No. 43 dated 16.05.2020

Vested Rights on Credits – The Rights:

We will now look into the aspect whether transitional credit that got accumulated to the taxpayer in the previous law is a vested right. Before we delve upon this issue, we will look into the evolved jurisprudence on the concept of vested right. The legal definition of the term 'vested right' under Merriam Webster's dictionary is 'a right belonging completely and unconditionally to a person as a property interest which cannot be impaired or taken away (as through retroactive legislation) without the consent of the owner'. In simple words, if credit is held to be vested right, no subsequent legislation can take away such benefit from the tax payer. If such credit is held not to be vested right, then the legislation can take away such benefit by way of legal sanction. We shall understand more about the concept of 'vested right' by looking at the jurisprudence under the earlier indirect taxation laws. Basis above, then we shall try to understand whether transition credit is a vested right or not.

In the matter of Eicher Motors Ltd[7] - Supreme Court:

The petition before the Honourable Supreme Court in this matter is the validity and application of modvat scheme, as modified by introduction to Rule 57F of Central Excise Rules, 1944, under which the credit, which was lying unutilised with manufacturers, stood lapsed in the manner is questioned. The petitioners prayed to quash the said rule mainly on four grounds – (1) Modvat credit lying in balance with the assessee as on 16.03.95 represents a vested right accrued or acquired by the assessee under the existing law and such right is sought to be taken away by the impugned rule and the Central Government has no powers under Section 37 of Central Excise Act, 1944 to frame such rule, (2) the impugned rule is arbitrary and unreasonable as the same has been framed without due application of mind to relevant facts, (3) Section 37 of the Act does not enable the Central Government to frame a rule enabling the lapsing of the balance in modvat account and is therefore ultra vires the rule-making power, (4) the rule is vitiated on the ground of promissory estoppel and/or the doctrine of legitimate expectation.

The Honourable Supreme Court after hearing to the revenue, held vide Para 5 as *'....Thus, the assessee became entitled to take the credit of the input instantaneously once the input is received in the factory on the basis of the existing scheme. Now by application of Rule 57F(4A) credit attributable to inputs already used in the manufacture of the final products and the final products which have already been cleared from the factory alone is sought to be lapsed, that is, the amount that is sought to be lapsed relates to the inputs already used in the manufacture of the final products but the final products have already been cleared from the factory before 16-3-1995.*

Thus, the right to the credit has become absolute at any rate when the input is used in the manufacture of the final product. The basic postulate, that the scheme is merely being altered and, therefore, does not have any retrospective or retro-active effect, submitted on behalf of the State, does not appeal to us. *As pointed out by us that when on the strength of the rules available certain acts have been done by the parties concerned, incidents following thereto must take place in accordance with the scheme under which the duty had been paid on the manufactured products and if such a situation is sought to be altered, necessarily it follows that right, which had accrued to a party such as availability of a scheme, is affected and, in particular, it loses sight of the fact that provision for facility of credit is as good as tax paid till tax is adjusted on future goods on the basis of the several commitments which would have been made by the assessees concerned.*

[7](1999) 2 Supreme Court Cases 361

Therefore, the scheme sought to be introduced cannot be made applicable to the goods which had already come into existence in respect of which the earlier scheme was applied under which the assessees had availed of the credit facility for payment of taxes. It is on the earlier scheme necessarily the taxes have to be adjusted and payment made complete. Any manner or mode of application of the said rule would result in affecting the rights of the assessees.6.We may look at the matter from another angle. If on the inputs the assessee had already paid the taxes on the basis that when the goods are utilised in the manufacture of further products as inputs thereto then the tax on these goods gets adjusted which are finished subsequently. Thus, a right accrued to the assessee on the date when they paid the tax on the raw materials or the inputs and that right would continue until the facility available thereto gets worked out or until those goods existed.

Therefore, it becomes clear that Section 37 of the Act does not enable the authorities concerned to make a rule which is impugned herein and, therefore, we may have no hesitation to hold that the rule cannot be applied to the goods manufactured prior to 16-3-1995 on which duty had been paid and credit facility thereto has been availed of for the purpose of manufacture of further goods.

Key Take – Aways:

The Honourable Supreme Court in this matter have set a standard to state that once the tax is paid on inputs and the same was eligible at the time of payment of such taxes, the same shall stands to be eligible and admissible until such inputs were utilised. The Court stated that once a right accrued to the assessee on the date which they paid the tax on raw materials or inputs and that right would continue until the facility available thereto gets worked out or until those goods existed.

In the matter of Dai Ichi Karkaria Limited[8] - Supreme Court:

The question that the Honourable Supreme Court is seized in the above matter is, whether for the purpose of arriving the cost of intermediate product to be subjected to excise duty, the excise duty paid on the raw material has to be taken into consideration or not. The Revenue was of the view that for the purpose of arriving the cost of intermediate product, the excise duty paid on the raw material is to be taken into account, whereas the manufacturers contend that such excise duty paid on raw material is not required to be taken. The Revenue took a stand that if the credit of excise duty is not been granted, then for the purposes of ascertaining the cost of intermediate product, the excise duty paid on raw material would have been taken for sure and the modvat scheme did not alter the fundamental position. By virtue of it, the Revenue contended that the cost of raw material was not reduced. The modvat scheme resulted in reducing the excise duty on the excisable product. The Revenue contended that the ***credit of excise duty on the raw material in the register maintained for MODVAT purposes was only a book entry which might be utilised later for payment of excise duty on the excisable product. In other words, it matured when the excisable product was removed from the factory and the stage for payment of excise duty thereon was reached. Actually, credit was taken, that is availed of or utilised, at the time of the removal of the excisable product. Consequently, the cost of production of the excisable product was not reduced by the amount of MODVAT credit on the raw material. The credit was contingent credit. It might be disallowed under certain circumstances. It could not be withdrawn like a credit amount in a bank account. The manufacturer did not have any indefeasible right or title to it. The rules pertaining to***

[8]For citation, please refer supra.

MODVAT scheme made it clear that the MODVAT credit was in the nature of a set-off or an adjustment.
The Honourable Supreme Court then stated that there is no doubt that were it not for MODVAT scheme and the credit available on the excise duty paid on the raw material thereunder, the excise duty paid on the raw material would be a factor in determining the cost of the excisable product. The question that Supreme Court framed is does the MODVAT Scheme make a difference? Accordingly, the Honourable Court vide Para 17 and 18 held as under:

It is clear from these Rules, as we read them, that ***a manufacturer obtains credit for the excise duty paid on raw material to be used by him in the production of an excisable product immediately it makes the requisite declaration and obtains an acknowledgement thereof. It is entitled to use the credit at any time thereafter when making payment of excise duty on the excisable product.*** *There is no provision in the Rules which provides for a reversal of the credit by the excise authorities except where it has been illegally or irregularly taken, in which event it stands cancelled or, if utilised, has to be paid for.* ***We are here really concerned with credit that has been validly taken, and its benefit is available to the manufacturer without any limitation in time or otherwise unless the manufacturer itself chooses not to use the raw material in its excisable product. The credit is, therefore, indefeasible. It should also be noted that there is no co-relation of the raw material and the final product; that is to say, it is not as if credit can be taken only on a final product that is manufactured out of the particular raw material to which the credit is related. The credit may be taken against the excise duty on a final product manufactured on the very day that it becomes available.***

Key Take – Aways:

The Honourable Supreme Court in this matter was considering the inclusion of excise duty paid on raw material for calculation of cost of intermediate product. The assessee was of the view that since the credit is available of such taxes, the same cannot be included in the cost of intermediate product. The Revenue was of the view that the credit availed on the raw material will mature only at the time when the final product is removed from the factory, until then the credit is contingent. The Honourable Court found no logic behind the submission of Revenue and held that once credit is available to the assessee, it becomes indefeasible and the credit becomes available on the very first day the raw material is purchased. The Court made general observations pertaining to the credit and made such a statement.

In the matter of Samtel India Limited [9] - Supreme Court:

In the said case, Rule 57F(17) of Central Excise Rules provided for lapse of credit accumulated on manufacture of tractors, motor vehicles and shall not be utilised for payment of duty on any excisable goods whether cleared for home consumption or for export. The said provision has been brought into effect from 16.03.1995. Appellant exported goods and claimed refund of CENVAT Credit accumulated upto Feb 1995. These claims of refund was rejected on the ground that under sub-rule 17, stating that the credit has been lapsed and the same cannot be refunded. In the context, the Honourable Supreme Court vide para 7 and 8 held as under:

[9](2003) 11 Supreme Court Cases 324

7. Thus, the then sub-rule 4A is identical to sub-rule 17 which is under consideration. In Eicher Motors case (supra), ***it has been held that the assessee became entitled to take the credit on the input having been received in the factory on the basis of the existing Scheme. It is held that the right to credit became absolute when the input was used in the manufacture of the final product. It is held that the incident following thereto must take place in accordance with the Scheme under which the duty had been paid on the manufactured product. It is held that if such a situation is sought to be altered necessarily it follows that right which accrued to a party gets affected. It is held that the Scheme sought to be introduced cannot be made applicable to the goods which had already come into existence in respect of which the earlier Scheme was applicable and under which the assessee had availed of the credit facility for payment of taxes. It is held that the right which accrued to the assessee on the date when they paid the taxes would continue until the facility available thereto gets worked out or until those goods existed. It is held that the amended sub-rule could not be applied to the goods manufactured prior to 16th March, 1995*** *(date on which sub-rule 4A came into existence).*

8. The principles laid down in Eicher Motors case (supra) are fully applicable, here. It is however submitted that is no challenge to the validity of sub-rule 17. It is submitted that this Court cannot, therefore, strike down nor read down sub-rule 17. It is submitted that in the absence of such a challenge full effect has to be given to the wording of sub-rule 17. It is submitted that sub-rule 17 specifically provides that the credit would lapse and that credit shall not be allowed. We are unable to accept this submission. What was then sub-rule 4A is now sub-rule 17(a). Sub-rule 17(b) is identical to sub-rule 17(a) except that it is in respect of a different final product. Once a validity of a provision is challenged and the validity is upheld by reading down that provision, then it is not necessary that in all subsequent proceedings the validity must again be challenged. It is sufficient if a party claims that the provision has to be read in the manner laid down by a judgment of this Court. In the light of the judgment of this Court in Eicher Motors case (supra), sub-rule 17 cannot apply to vested rights. Therefore to the extent that the goods have already been exported, prior to March, 1997, the assessee would be entitled to a refund.

Key Take – Aways:

The Honourable Supreme Court in this matter by following its earlier decision in Eicher Motors Ltd (supra) has held that credit once eligible, the same cannot be subsequently taken away in the form of amendment. The Court after observing the fact pattern is similar to the Eicher Motors Ltd (supra) has followed the same.

In the matter of Osram Surya (P) Limited[10] - Supreme Court:

The facts involved are that Rule 57G of the erstwhile Central Excise Rules, 1944 are amended to provide additional condition that the credit should be availed within 6 months from the date of issue of duty paying documents. This amendment was also challenged on the ground that it is taking away the vested right with respect to the invoices received prior to the amendment and credit was not yet availed. In this context, the Honourable Supreme Court upheld the amendment by stating that the amendment is not taking away any vested right and is merely introducing limitation for availment of credit. Vide Para 9, the court held as under:

[10](2002) 9 Supreme Court Cases 20

Without such a challenge, the appellants want us to interpret the rule to mean that the rule in question is not applicable in regard to credits acquired by a manufacturer prior to the coming into force of the rule. This we find it difficult because in our opinion the language of the proviso concerned is unambiguous. It specifically states that a manufacturer cannot take credit after six months from the date of issue of any of the documents specified in the first proviso to the said sub-rule. ***A plain reading of this sub-rule clearly shows that it applies to those cases where a manufacturer is seeking to take the credit after the introduction of the rule and to cases where the manufacturer is seeking to do so after a period of six months from the date when the manufacturer received the inputs. This sub-rule does not operate retrospectively in the sense it does not cancel the credits nor does it in any manner affect the rights of those persons who have already taken the credit before coming into force of the rule in question. It operates prospectively in regard to those manufacturers who seek to take credit after the coming into force of this rule. Therefore, in our opinion, the Tribunal was justified in holding that the rule in question only restricts a right of a manufacturer to take the credit beyond the stipulated period of six months under the rule. Therefore, this appeal will have to fail.***

Key Take – Aways:

The Honourable Supreme Court in this matter dealt may be for the first time a situation which places restriction on the credits prospectively. The Honourable Court found that a prospective rule which states the credit will be lost if the assessee does not avail the same within a prescribed time period cannot be said to disturb or cancel the credits in any manner rights of those persons who have already taken the credit before the said rule coming into effect. In other words, the Honourable Court laid down a precedent stating that if any subsequent amendment is not disturbing the earlier granted rights, the same cannot be said to be disturbing the vested rights.

In the matter of Cellular Operators Association of India[11] - Delhi High Court:

In the facts of the said case, Education Cess (EC) and Secondary Higher Education Cess (SHEC) were not payable on excisable goods with effect from 01.03.2015 vide Notification Nos. 14/2015-C.E. and 15/2015-C.E. both dated 1st March 2015. EC and SHE were also abolished and ceased to be payable on taxable services when Section 95 of Finance Act (No. 2) 2004 and Section 140 of Finance Act, 2007 were omitted by Finance Act, 2015. The omission was to take effect from 1stJune 2015 vide Notification No. 14/2015-S.T., dated 19thMay 2015.

As a result, levy of EC and SHEC on excisable goods was withdrawn with effect from 1st March 2015 and in respect of taxable services with effect from 1stJune 2015. The petitioners do not have any grievance against the withdrawal or abolition of levy of EC and SHE. The grievance of the petitioners is, and they claim a vested right to avail benefit of the unutilized amount of EC or SHE credit, which was available and had not been set off as on 1stMarch 2015 and 1st June 2015 for payment of tax on excisable goods and taxable services respectively. The contention of the assessee is that EC and SHE were subsumed in the central excise duty and accordingly the general rate of which was increased from 12% to 12.5%, and service tax, which was increased from 12.36% to 14%. In this case, it was held as under:

[11]2018(14) GSTL 522 (Del)

The decision in the case of Eicher Motors Limited and Another (supra) is distinguishable, for in the said case, what was subject matter of challenge was Rule 57F(4A), which had stipulated that unutilized credit as on 16th March, 1995 lying with the manufacturers of tractors under Heading 87.01 or motor vehicles 87.02 and 87.04 or chassis of tractors or motor vehicles under Heading 87.06 shall lapse and shall not be allowed to be utilized for payment of duty on excisable goods. The proviso, however, had stipulated that nothing shall apply to the credit of duty, if any, in respect of inputs lying in stock or contained in finished products lying in stock as on 16th March, 1995, thereby creating an anomalous situation. Credit of tax paid on inputs and even finished products was available, but not in respect of the sold products. This was clearly taking away a vested right in the form of an amendment to the Rule. There was lapse of credit, which could not be utilized, though the tax/duty had not been withdrawn. The Supreme Court noticed that the credit attributable to inputs had already been used in manufacture of final products that had been cleared, and this alone was sought to be lapsed, notwithstanding the fact that the right had become absolute. On a holistic reading of the entire scheme, it was observed that when acts have been done by the parties concerned on the strength of the Rules, incidence following thereto must take place in accordance with the scheme or the Rules, otherwise it would affect the rights of the assessees. Further, right had accrued on the date when the assessee had paid tax on the raw materials or inputs and the same would continue till the facility available thereto got worked out or until the goods existed. As noticed above, tax/duty had not been withdrawn. Lastly and more importantly, Section 37 of the Central Excise Tariff Act, 1985 (sic) did not enable the authorities to make the Rule impugned therein. The legal ratio in Eicher Motors Limited and Another (supra) was followed in Samtel India Limited (supra) wherein amended Rule 57F(17) of the Central Excise Rules, 1944 was challenged. ***The Rules had postulated lapsing of credit in case of manufactured goods falling under sub-heading 8540.12, though the proviso had provided for credit of duty in respect of inputs lying in stock or contained in finished goods lying in stocks. It was held that the said scheme of credit of input tax, in view of amended provision, could not be made applicable to goods which had already come into existence and under which the assessee had claimed credit facility. As noticed above, in the present case, credit of EC and SHE could be only allowed against EC and SHE and could not be cross-utilized against the excise duty or Service Tax. In fact, what the petitioners seek is an amendment of the scheme to allow them to take cross-utilization of the unutilized EC and SHE upon the two cesses being withdrawn against excise duty and Service Tax, though this was not the position even earlier. Both EC and SHE were withdrawn and abolished. They ceased to be payable. In these circumstances, it is not possible to accept the contention that a vested right or claim existed and legal issue is covered against the respondents by the decision in Eicher Motors Limited and Another (supra) and Samtel India Limited (supra). The said decisions are distinguishable and inapplicable.'***

Key Take – Aways:

The Delhi High Court while rejecting the plea of vested right qua EC and SHEC stated that since the such cesses were abolished and no such cesses were required to be paid on output, the credit of such cesses cannot be allowed as a matter of right. The High Court stated that what the assessee was asking to permit is something which the law itself has not provided. The utilisation of credit of cesses against payable of service tax and excise duty was never contemplated in the scheme of CENVAT credit rules and the credit cannot be allowed to be set off despite of the fact that the increase of rate of output tax/duty was due to subsuming of such cesses. The Honourable Court distinguished the Eicher Motors Ltd (supra) and Samtel India Limited (supra) and stated they are inapplicable.

In the matter of Jayam &Co[12] - Supreme Court:

The facts involved are that the Appellant is a dealer in television (TVs) sets. The Appellant purchased TVs from LG Electronics Private Limited by paying the applicable tax (say purchase price Rs. 100 and VAT Rs 10). The Appellant obtained discount for the TVs purchased from LG Electronics Private Limited (discount of Rs. 20 making the effective purchase cost excluding taxas Rs. 80). The Appellant sold the TVs to his customer at a price higher than the discounted purchase price and lower than the original price at which purchase was made. (Sale price Rs. 95 and taxcharged Rs. 9.5). This resulted into a higher value added tax (VAT) input claim (Rs 10) than the VAT output (Rs 9.5). Under these kind of price arrangements, there is a possibility of moving higher amount of input VAT from one entity to the other entity as compared to the commensurate value of goods by artificially increasing the sale price of goods to charge higher VAT amount at the time of sale and later on reducing the price by way of discount. Noticing this possibility, amendment was made to TN VAT Act[13] by inserting sub-section (20) in section 19.

In light of the above sub-section, the excess input VAT claimed (i.e. Rs 0.5) over the output VAT is required to be reversed by the taxpayer. This amendment was given retrospectively with effect from 01st January 2007. In light of the amendment introduced, the same was challenged for its retrospective operation because the amendment is of such nature that it is taking away there vested right over the input VAT accumulated. On the issue of retrospective operation, it was held by the Honourable Supreme Court vide para 18 as under:

*When we keep in mind the aforesaid parameters laid down by this Court in testing validity of retrospective operation of fiscal laws, we find that the amendment in-question fails to meet these tests. The High Court has primarilyg one by the fact that there was no unforseen or unforeseeable financial burden imposed for the past period. That is not correct. Moreover, as can be seen, sub-section (20) of Section 19 is altogether new provision introduced for determining the input tax in specified situation, i.e., where goods are sold at a lesser price than the purchase price of goods. T**he manner of calculation of the ITC was entirely different before this amendment. In the example, which has been given by us in the earlier part of the judgment, 'dealer' was entitled to ITC of Rs. 10/- on re-sale, which was paid by the dealer as VAT while purchasing the goods from the vendors. However, in view of Section 19(20) inserted by way of amendment, he would now be entitled to ITC of Rs. 9.50. This is clearly a provision which is made for the first time to the detriment of the dealers. Such a provision, therefore, cannot have retrospective effect, more so, when vested right had accrued in favour of these dealers in respect of purchases and sales made between January 1, 2007 to August 19, 2010.Thus, while upholding the vires of sub-section (20) of Section 19, we set aside and strike down Amendment Act 22 of 2010 whereby this amendment was given retrospective effect from January 1, 2007.***

On the aspect of validity of the amendment, the Honourable Court upheld the amendment, though prospectively, which is evident from these paras *'It is a trite law that whenever concession is given by statute or notification etc. the conditions thereof are to be strictly complied with in order to avail such concession. Thus, it is not the right of the 'dealers' to get the benefit of ITC but it's a concession granted by virtue of Section 19. As a for tiorari, conditions specified in Section 10 must be fulfilled. In that hue, we find*

[12]For citation, please refer supra.

[13]Tamil Nadu Value Added Tax Act, 2006.

that Section 10 makes original tax invoice relevant for the purpose of claiming tax. ***Therefore, under the scheme of the VAT Act, it is not permissible for the dealers to argue that the price as indicated in the tax invoice should not have been taken into consideration but the net purchase price after discount is to be the basis. If we were dealing with any other aspect do hors the issue of ITC as per the Section 19 of the VAT Act, possibly the arguments of Mr. Bagaria would have assumed some relevance.*** *But, keeping in view the scope of the issue, such a plea is not admissible having regard to the plain language of sections of the VAT Act, read along with other provisions of the said Act as referred to above.*

*For the same reasons given above, c****hallenge to constitutional validity of sub-section (20) of Section 19 of VATAct has to fail. When a concession is given by a statute, the Legislature has power to make the provision stating the form and manner in which such concession is to be allowed. Sub-section (20) seeks to achieve that. There was no right, inherent or otherwise, vested with dealers to claim the benefit of ITC but for Section 19 of the VAT Act. That apart, we find that there were valid and cogent reasons for inserting Section 19(20). Main purport was to protect the Revenue against clandestine transactions resulting in evasion of tax.'***

Key Take – Aways:

The Honourable Supreme Court has categorically held that with respect to the input VAT that was already accumulated to the dealers prior to the amendment, the same was accrued unconditionally or all the conditions that were in force prior to the amendment were satisfied and right to claim the input VAT was accumulated to the dealer. In view of this reason, the apex court held that the input VAT accumulated prior to amendment was a vested right. With respect to validity of the amendment, the apex court taken a view that input VAT is a benefit or concession to be conferred by a statue and it is the prerogative of the legislature to prescribe the conditions that may be relevant to claim such benefit or concession. Accordingly, the apex court upheld the validity of amendment for prospective operation.

Summarising the verdicts:

The above are some of the important judgments which elucidate the concept of vested right. The decision of Eicher Motors Ltd (supra) is the earliest one from the Honourable Supreme Court, wherein it was held that once the credit was available to the assessee, the same cannot be taken away by way of subsequent amendments. Though, the decision of Dai Ichi Karkaria Limited (supra) does not deal exclusively on the issue of vested right, the Court made an important observation stating that credit is indefeasible and the same is not contingent. Post to that, the decision of Eicher Motors Ltd (supra) is followed in the matter of Samtel IndiaLimited (supra). It is also important to note that Eicher Motors Ltd (supra) and Samtel India Limited (supra) were rendered in situations where the credit was newly introduced and the restrictions that a credit suffers today were not there then.

When the issue came before the Supreme Court in the matter of Osram Surya (P) Limited (supra), we can see that there is some sort of maturity in the cenvat credit system both at the implementation level and adjudication level. The Supreme Court rightly observed that by way of introduction of a new rule barring the availment of credit post certain period does not in any way effect the rights already created.

The Delhi High Court in the matter of Cellular Operators Association of India (supra) stated that in situations where cesses where were abolished on output, there cannot be said a vested right created in favour of the assessees in respect of the cesses already availed. The Delhi High Court rejected the plea of allowing of such credit of cesses to be set off against the output tax/duty payable, since the cesses can not be equated to output taxes/duties. The Delhi High Court stated that such cesses were allowed only for the reason that the similar cesses were payable on output. When the cesses on output were abolished prospectively, the said action cannot be stated to be taking away the vested rights. The Supreme Court in Jayam & Co (supra) again by following the decision of Eicher Motors Ltd (supra) and Samtel India Limited (supra) held that action of insertion of rule disturbing the past credit position was invalidated.

With this understanding of the above jurisprudence on the issue of vested right, in the opinion of the paper writers, the following principles emanate in understanding the meaning of a 'vested right':

- A right gets vested when the credit is availed
- Such right cannot be taken away by way of subsequent amendments to the statute
- Prospective conditions imposing availment/restriction cannot be said to be taking the vested rights away
- No vested right in case where credit was given on condition that such credit can be used against similar output

With this understanding on vested rights, we will examine whether the CENVAT Credit accumulated under the erstwhile regime by way of availment in the prescribed returns[14] is of the nature of vested right or not.As mentioned above, the High Courts have taken a different view:

[14]Section 140 of CT Act provides for availment of various kinds of transitional credit. We restrict analysis credit qua Section 140(1) alone.

Extrapolating the above Principles to TRAN Credit:

Now, let's take the leading judgments on this matter and apply the above principles.

Judgement	Reasoning by Courts	Comments
Willowood Chemicals Private Limited	• The HC held that the prescription of time limit for transitioning credit from earlier to GST regime will not take away the vested right since the credit is a concession or benefit provided by the legislature and the same can be regulated. • The said conclusion was arrived by following the decisions of Supreme Court in Jayam & Co (supra), Reliance Industries Limited (supra) and Godrej & Boyce Mfg Co. Pvt Limited (supra). • The Court stated that the credit is given in electronic credit register only subject to making necessary declarations in prescribed format within the prescribed time. • The Court distinguished judgments of Eicher Motors Ltd (supra) and Dai Ichi Karkaria Limited (supra) by stating that conclusions arrived therein was that the MODVAT credit in account of manufacturer is in nature of duty already paid and which cannot be taken away by retrospective rules.	• In the facts of the matter, since the State VAT laws were allowing the refund of the tax that was not being taken forward to GST regime, there is a possibility that the HC would have come to the conclusion that there is no disturbance to vested rights. To this extent, a distinction can be made on the facts. • However, seen in a different perspective, the Gujarat HC also dealt all the judgments which were given in the context of 'vested right', a view can also be taken that irrespective of whether the tax is refunded or not, the judgment lays down a valid prescription regarding vested rights. • In our view, if the CT Act states that the credit availed during earlier regime cannot be carried forward in any manner, then the principles enunciated by SC in Eicher Motors Ltd (supra) and others can be followed. • However, when the CT Act allows the said credit to flow from the earlier laws, subject to filling of the forms and within the prescribed time limit and failure to do so by the assessee, the assessee cannot plead for disturbance of vested rights.

Siddharth Enterprises	• The HC held that the right to carry forward the credit from earlier regime is saved in terms of Section 174 and therefore cannot be allowed to lapse under Rule 117 for failure to declaration in the prescribed form within the due date. • The HC followed the judgments of Eicher Motors Ltd (supra) and Dai Ichi Karkaria Limited (supra) and accordingly held that the TRAN Credit is a vested right.	• The HC has proceeded on the reasoning that since the objective of the GST laws is to remove cascading effect and failure to allow the transition credit would result in cascading effect rejected the time limit prescribed under Rule 117. • In our view, judgment of HC may requires reconsideration because, as stated earlier, the CT Act does not restrict the earlier credit but allows the credit subject to declaration in forms and filing within the due date. In absence of such declaration in such forms and time limit, the claims would continue in infinitum and the tax authorities would be clueless to verify the credit. Hence, such conditions cannot be said to be taking away the vested rights but only to regularise the vested rights.

Therefore, in light of the above discussion, we understand that all the judgements of various High Courts have failed to determine the following questions by referring to the available jurisprudence in an exhaustive manner:

- Whether CENVAT Credit that was already carried forward in the returns filed under existing law by satisfying all the conditions amounts to 'vested right' and is required to be claimed as transitional credit under GST regime despite not meeting the procedural conditions?

- Whether section 164 of the CT Act which provides for general rule making power can affect the existing rights and liabilities of a taxpayer?

- Whether retrospective amendment to Section 140 to validate Rule 117 by reading time limits into Section 140 can operative retrospectively by statutory force when it has the implications of taking away the already accrued 'vested rights'?

With this, we now proceed to understand whether retrospective amendment can be brought into statute to take away the already accrued vested rights.

Validity of Retrospective Amendment to Section 140 – The Retrospectivity:

As mentioned in the introduction, the Finance Act, 2020 made retrospective amendment to Section 140 to read timelines to avail various types of transition credit in order to validate the time limit prescribed under Rule 117.As stated earlier, such amendment to Section 140 to prescribe time lines may be viewed as abundant caution and to remove any possible interpretation that the Rule 117 does not have power to do so. The view that the amendment of Section 140 itself validates that Rule 117 does not have power to prescribe so, in our view, may not stand to legal scrutiny.

The real question is that, whether the CENVAT Credit, which is undoubtedly, assumes the character of 'vested right' can be disturbed by asking the assessee to fill a specified form and in time limit, when moving to the GST regime. In our view, just because a time limit is attached to regularise the transition credit, by itself, should not be taken as disturbing the 'vested right'. For example, look at one of the conditionsin proviso to Section 140(1) which states that the registered person is not allowed to take credit where the said amount of credit is not admissible as input tax credit under CT Act.

In our view, this condition has to be challenged on the ground that it is disturbing the earlier vested credits. For example, if a credit was allowed under the earlier CENVAT Credit Rules but not allowed under Section 17(5) of CT Act, the proviso states that such credit cannot be carried forward to GST regime. This would be disturbing the earlier vested right because the condition which was not available at the time of availment cannot be enforced when moving to the GST regime. Conditions like these have to be struck down by following the decisions of Eicher Motors Ltd (supra), Samtel India Limited (supra), Osram Surya Private Limited (supra) and Jayam & Co (supra).

However, conditions like filing the prescribed forms within the time limit does not disturb the 'vested right', in our view, they have to be seen as conditions facilitating the transition credit. However, if a tax payer for ingenuine reasons cannot file the forms within the time limit, then he cannot raise the plea that such credit should be allowed based on the reasoning of 'vested right'. The decision of Brand Equity Treaties Limited (supra) prescribing the time limit under Limitation Act should be applied for transition credit, in our view, went a bit overboard. If such time limit under Limitation Act is available for transition credit, why the same should not be applied for Section 16(4) of CT Act. In similar way, all time limits prescribed vide the act or rules can be replaced with time lines specified under Limitation Act. Hence, in our view, the condition of filing relevant forms and within time limit, be it, vide act or rules, should be held to be intra-vires and the courts in India have consistently held that retrospectivity of tax law is legal.

Conclusion:

The three questions that were dealt in this article are highly debatable and concluding with a single view is a sin. It is for the Honourable Supreme Court to put rest to the above issues. However, we try to conclude in the subsequent paras, our views/conclusions on the questions raised.

The first, on the vires, we are of the view that the going based on the objective of the GST laws and the jurisprudence, there are bright chances for stating that the Rule 117 prescribing the time limit is intra-vires. However, the time limit may also be viewed as substantial condition since it has potential of disturbing the old credits if not acted within the time limit, an alternate view is also possible, such time limit should have been prescribed by CT Act and should not be left to rules.

The second, on the vested right, undoubtedly, the CENVAT credit is vested right and the same cannot be taken away by subsequent amendments. However, since the CENVAT credit is vested right, it does not follow, that the credit can be availed at the whims and fancies of assessee. Hence, the credit though vested right, the same has to be made good by following the time lines prescribed.

The third, on the retrospectivity, there is no bar to retrospectively amend the tax law and it is not a strange thing. The only issue is that whether the amendment to insert time limit in Section 140 would by itself make Rule 117 ultra-vires. As stated earlier, this it self may not be reason to struck down Rule 117.

As stated earlier, we do not certain answers for the questions raised. However, the answers would affect the credits involved. The Honourable Supreme Court has to put rest to all of this and no idea how much time it would take for the same. Till then, Fingers crossed!

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