

Chandigarh, Wednesday, February, 19, 2003

Query: I run a cosmetics distribution agency business and have admitted my brother-in-law into my sole proprietorship concern wef December; 2002. My brother-in-law is holding 20% share in the partnership firm. I have received Rs 2 lakh towards goodwill from him. Will there be any capital gain? .

Opinion: The Supreme Court in CIT v. H. Rajan & H. Kanan (1999) 236 ITR42 (SC) has held that where a person is admitted into a firm as a partner, there could be no transfer to yield any profit or gain to the transferor which could be subjected to tax under section 45. However, where the assessee received a consideration for the admission of a partner into the firm towards goodwill then it is liable to tax under Section 55(2) (a). Therefore, the entire consideration towards goodwill is chargeable to tax.

Note: In case of firm of professionals, the admission of another professional, even with explicit claim as goodwill will not result in any capital gain because section 55(2)(a) deals with "goodwill of a business" only and not goodwill of a profession.

Clubbing of Income

Query: I gifted my building in Chandigarh to my wife on 1-4-2002. She earned a rental income of Rs 3 lakh during the year In August, 2002, my wife gifted a vacant site at the outskirts of Panchkula as gift to me, which I gave on lease to earn an income of Rs 7,000 per month. I have been advised that this planning does not hold good. Please advise.

Opinion: According to Section 64(1)(vi), unless the transfer between spouse is for adequate consideration or in connection with an agreement to live apart, the asset transfer will have no consequence in tax law. The rental income of the building earned by your wife will be taxed in your hands. The vacant site rent similarly earned by you will be taxable in the assessment of your wife.

Cash Credit in Partners' Account

Query: Can the Assessing Officer tax the cash credits in our partner's capital account while assessing the partnership firm?

Opinion: Where the partners join the firm and contribute capital then the source for the investment must be explained by the partners and the firm cannot be subjected to tax. Where the partners contribute capital at the time of commencement of the firm more so the liability or the responsibility to explain the source for the investment would remain with the partners and the firm accepting capital from the partners cannot be liable to tax in respect of the cash credits appearing in partners capital accounts. India Rice Mills v. CIT (1996) 218 ITR 508 (All). Therefore, the assessing officer cannot tax the cash credits in your partner capital accounts, in the hands of the firm but can definitely relate and question your personal source of investment in your personal assessment.

Claim of Debit Balance

Query: Mr Mistri retired from partnership and still owed Rs 90,000 to the firm. He has expressed his inability to repay the same. Please advise whether this amount can be claimed as a deduction in the firm's

assessment? Whether this amount shall be an income in the hands of Mr Mistri?

Opinion; A debt can be written off as bad debt only if the amount was advanced in the regular course of business, A partner making excess withdrawal from the firm will not tantamount to advancing of money by the firm in the course, of its business.

The sum outstanding from the retiring partner hence will not be eligible for deduction.

A sum received by the retiring partner in excess to the capital is not a capital gain, Also, it is not an income in the sense that the amount owed by him is the result of excess drawings etc 'and it cannot be covered by section 28(iv) which is meant to tax only benefit or perquisite arising in the course of business or exercise *of* profession. The amount excessively drawn and not paid by Mr Mistri is not chargeable to tax.