IN THE INCOME TAX APPELLATE TRIBUNAL
CIRCUIT BENCH : MANGALORE

BEFORE SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER
AND SHRI SUDANSHU SRIVASTAVA, JUDICIAL MEMBER

ITA Nos.1376 & 1377/Bang/2015
Assessment years : 2009-10 & 2010-11

The Assistant Commissioner of Income Tax, Central Circle 1, Mangaluru.	Vs.	Dr. Ali Kumble, No.4, Water Woods, Sathyajit Nagar, Kadri Kaibattal, Mangalore. **PAN: ACAPA 5798F**
APPELLANT		RESPONDENT

ITA Nos.1378 & 1379/Bang/2015
Assessment years : 2009-10 & 2010-11

The Assistant Commissioner of Income Tax, Central Circle 1, Mangaluru.	Vs.	Dr. Yusuf Kumble, No.703, West Wind, Near DC Bungalow, Collectors Gate, Mangalore. **PAN: AFHPA 0556M**
APPELLANT		RESPONDENT

Revenue by	:	Shri R.S. Siddappaji, Addl. CIT(DR)
Assessee by	:	Shri V. Srinivasan, Advocate

Date of hearing	:	02.02.2017
Date of Pronouncement	:	03.05.2017

O R D E R

Per Inturi Rama Rao, Accountant Member

These appeals filed by the Revenue against the different orders of the CIT(Appeals), Panaji-2 dated 28.07.2015 for the assessment years 2009-10 & 2010-11 in respect of two assesses. Since common issue is involved in these appeals, we proceed to dispose of the same by this consolidated order.

2. For the sake of clarity and convenience, the facts relevant to AY 2009-10 in the case of Dr.Yusuf Kumble in ITA No.1378/Bang/2015 are stated herein. The Revenue raised the following grounds:-

> "1. The order of the learned CIT(A) is opposed to Law and facts of the case.
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> 2. The CIT(A) ought to have upheld the decision of the Assessing Officer of taxing the capital gain arising on the transfer of land of 1.50 acres consequent upon the conversion of the firm M/s Medicity Hospital and Research Centre into the company M/s Mangalore Indiana Hospital Pvt. Ltd., in the hands of the assessee.
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> 3. The learned CIT(A) has erred in concurring with the assessee that the land was transferred at cost to the firm and the subsequent revaluation of the land and conversion of the firm into company were effected within the legal framework and therefore there is no incidence of capital gain in the hands of the assessee.
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> 4. The learned CIT(A) has erred in holding that the creation of the firm and its conversion into the company was a legal requirement and there is no infirmity in the same and that the land was introduced at cost, as capital into the firm and as it was not sold after revaluation and the doctor brothers had not received any consideration, capital gain does not arise.

5. The land of 0.64 acre has been introduced as capital into the firm at Rs.4.48 crores as is apparent from available documents which the learned CIT(A) has failed to observe.

5. The increase in the value of 1.50 acres of land after revaluation in the books of the firm has been credited only to the capital accounts of Dr.Ali Kumble and Dr.Yusuf Kumble and not to the capital accounts of other partners on the basis of their share in the partnership. This is an inconsistency which the learned CIT(A) has failed to observe.

7. The assessee and his brother Dr.Ali Kumble have received an advance of RS.1 crore apart from shares worth Rs.12 crores as consideration for the land valued at Rs.13 crores, on conversion of the firm M/s Medicity Hospital and Research Centre into the company M/s Mangalore Indiana Hospital Pvt. Ltd. in violation of clause (c) of section 47(xiii) of the Income tax Act,1961 which infraction the learned CIT(A) has failed to take cognizance.

8. The partnership deed has been amended 4 times during 2009 and the dates of the stamp papers on which the various deeds have been executed and the dates of registration are not in conformity with the chronological sequence of the deeds and the Supplemental Addendum to partnership deed dated 02.04.2009 by way of rectification of apparent errors is made on 23.03.2010 which is after the conversion of the firm into the company M/s Mangalore Indiana Hospital Pvt. Ltd. and therefore indicate "mens rea' and subterfuge on the part of the assessee and that the firm M/s Medicity Hospital and Research Centre is a "colourable device" that was created to evade tax and consequently, there would be incidence of capital gains in the hands of the assessee which fact the learned CIT(A) has failed to observe.

9. The learned CIT(A) has erred in concurring with the assessee that the transfer of land to the company has been done within the legal frame work notwithstanding the afore cited blatant infringement of legal technicalities.

10. The learned CIT(A) has failed to appreciate that the legislative intent of section 47(xiii) is to encourage business reorganizations to continue the business of the firms by allowing the advantage of carrying forward losses and unabsorbed

depreciation on conversion of firm into company and not to function merely as devices to secure a tax advantage.

11. For these and such other grounds it is urged that the order of the learned CIT(A), on the above points may be set aside and the order of the Assessing Officer be restored.

12. The appellant craves leave to add, alter or amend all or any of the grounds of appeal before or at the time of the hearing of the appeal."

3. The facts in brief are that the respondent-assessee is an individual deriving income from profession as a medical Doctor. The return of income for AY 2009-10 & 2010-11 was filed and processed u/s. 143(1) of the Income Tax Act, 1961 ["the Act"]. Subsequently, there was search & seizure operation conducted in the residential premises of respondent-assessee on 23.11.2011. During the course of search operations, the investigating wing of the department found certain material alleged to be incriminating material in the form of Minutes of the Board meeting which are extracted below:-

"9. <u>Evidence from the seized material:</u>

9.1. It is evident from the seized materials that the assessee has conspicuously planned the programme to avoid the capital gain tax on the land acquired for the hospital project with the help of one Sri. Venugopal, who is a professional in this matters. It is seen from the seized materials that the assessee has taken advice from Sri. Venugopal frequently on the matters of Income Tax and followed his instructions religiously. According to that the assessee has tailor made his program thread by thread and executed it by forming a firm only in the paper and acquired the required land and revalued it step by step to the actual cost. It is evident from the statement mentioned in the minutes of meeting

held on 21.03.2008 **(The project is of Rs. 50 crore approximately of which the land value itself is about Rs.12 crore)** that the actual land cost is approximately Rs. 12 Crore

9.2. The seized material inventorised as IHHIL/12 dated 23.11.2011 contains copy of proceedings of the meeting held at Alif Institute of Medical Sciences Pvt. Ltd., (which is renamed as Indiana Hospital & Heart Institute Ltd.) on 19.12.2007, Minutes of Board Meetings of Alif Institute of Medical Sciences Pvt. Ltd. held on 08.02.2008, 15.03.2008 and 21 st March, 2008.

9.3. Given below the extract from the proceedings held at Alif Institute of Medical Science Ltd held on 19.12.2007 that:-

" ..... the partnership firm transfer to private limited.co (following IT and for avoiding capital gain within one year to private to public 86 cents land purchase is already firm's property as *per deed* of *partnership. Other properties to be transferred to firm change in consultation* as *March 1st 2008* & *bring it into common stock. Finally from firm to Company final partnership deed constant amendment fresh deed business from January to March 31-03-2008 revalue the partner account* to *be created 01-04-2008 transfer* to *private Ltd. Company business* of *firm plus all assets* & *liabilities* to *be transferred under secession agreement. Taking loans from abroad - ECB guidelines attracted Rs.75 Lakhs sundaram loan to be substituted personal loan source / identity /business/ income/ banker certificate/cheque NRI a/c. Loan or* a *gift clearing loan Sundaram finance issue shares to the NRI in respect* of *the loan Rs.25 Lakhs & issue receipt & take* as *share application money immediately increase share capital' The co. should give advance to firm & firm should give to partner firm should give* a *letter to* co. *stating that they are in the process* of *acquiring the land inter it can be adjusted valuation report for revaluation* of *partnership firm around March,2008. Shares transfer Form, Form no .7 B, takeover all register enter all details & get all application board meeting for 3months.*

Register land in Company name, (39 *cents land yet to be transferred from individuals firm's name) land brought to common stock section 14* of *partnership act (86cents)*

July 2007 deed not filed with anyone enough it from 1 *is filed for firm. (AIi & Yusuf) brother gave the land as gift to them as it is agriculture land Rs.8 -10 Lakhs per cent quotes.*

Property value has gone up in Mangalore.

Last 24 *cents* of *land yet to come COI 22-08-2006 whatever land is to be brought why not buy in the name* of *the firm. Buy as partner on behalf* of *the firm (whether they can* go *by part IX risky clarity case held up) land Dr Partner Cr, succession* of *firm by company agreement between firm & company avoiding capital gains tax* 4 *to* 5 *condition must.*

-All assets & *liabilities to be transferred*

-All partners of *firm to be shareholders* of *the company.*

-Partners should hold 51% of *shares capital for at least* 5 *years (only 2 are these are other to be added) whether other doctors can be brought in as partners* of *the firm yes allowed but before the agreement with the company.*

"Succession of *firm by company in the same business as the firm" agreement with* a *view to have* a *succession. In the process* of *succession* of *firm by the company immediately before the succession*

-Partner business assets & *liabilities in the company same proportionate in which they have capital account balance in the company partner* of *the firm a/c not receive any considers others than shares in the company. Only shares can be allotted to the extent* of *their capital contributes.*

The aggregate of *the shareholding* of *the partner in the company is not less than 50%* of *the total voting power outsider allowed upto 50%, held for* a *period* of 5 *years than date* of *incorporation Rs.10 Crore to be put is at the of transfer it should be in same properties 24 cent to come on January 15, 2008 (court order as Jan 7/2008) 31-05-2008 - whatever you want to be with firm (Venugopal).*

Revalue assets enhance partner capital 31-03-2008 final balance sheet transfer on 01-04-2008. License from Mangalore Corporation - building license - whether it can be made in name

of the firm and then transferred. Firm should carry on same business before & upto 31-03-2008. Expansion project can be done in name of the company, deed of amendment not transfer for setting up a hospital within 2 months business can be carried on resolution of partner can pass a resolution of partners is enough Jan, Feb, March partner can pass a resolution that further business can be carried out in the name of company.

Bank account is already there in the firm's name, company does not have land upto March 31, 2008."

9.4 The above extract from the proceedings shows the meticulous planning of the assessee to avoid capital gain by forming a firm and acquire the land in its name and revalue the land in steps and finally transfer it to the company.

9.5 Further, the extracts from the Minutes of Board Meeting held on 08.02.2008 is as follows:-

"Dr. Yusuf Kumble took the chair and called the meeting to order.

The following points were discussed in the meeting.

1. *M/s Medicity Hospital and Research Centre - Partnership Firm holding land. It will be shortly taken over by the Company. Its books are to close by end* of *Feb 2008 or mid March 2008. Till now there are very few transactions in it. Purchase/Sale* of *medicines and* a *few other transactions should be shown from 23/03/2007 (date* of *formation* of *partnership) to 28/02/2008 for closing its books. For this purpose, the Directors should give us* a *photocopy* of *the Partnership Firm's Pass Book to date and also give* a *photocopy to Vinod Rao. Dr. Yusuf has given necessary instructions to Noushad in this regard.*

2. *The Company was incorporated on 07/08/2006. It will have to close its books on 31/03/2007 and prepare its Balance Sheet and Profit and Loss Account for that date and hold First Annual General Meeting on 31/12/2007 and do annual filing as early as possible. For preparing the accounts, they need to give* a *photocopy of the Bank Pass Book* of *the Company to us and Vinod Rao (their auditor), Vinod Rao will*

then prepare final accounts and deal with their income tax return for AY 2007-08, while we *will use the same information for doing annual filing* of *the Company for 2006-07. Necessary instructions were given by Dr. Yusuf to Noushad in this regard.* 11

9.6. From the above, it is very much evident that the assessee and others have preciously made the planning thread by thread to avoid paying capital gain tax to the country by forming a paper firm and acquire the land in its name and revalued it to the market value step by step.

9.7. Para 3 & 5 from the Minutes of Board Meeting held on 15.03.2008 is as follows:-

"3. Sri Vinod Rao has prepared the deposit agreement for every shareholder giving deposit to the Company. The directors raised a *point that only* 86 *cents land was with the partnership firm which was intended to be taken over by succession by the company. The succession agreement would be prepared by Sri. Vinod Rao. Another 39 cents were with Dr. Yusuf and Dr. AIi though nor brought into the Firm* as *yet. Further about* 25 *cents was with Dr. Yusuf and Haneef, being jointly held by them. On Dr. Yusuf's query on how to bring this land into the company, Vinod Rao said that as discussed with Sri. Venugopal, it would be advisable if all this land is brought into the books* of *the Firm and all other adjustments such as bringing in* of *Hannef into the partnership be made by March* 31, *2008,* so *as to enable succession* of *the firm by the Company and compliance with provisions* of *section* 47 *(xiii)* of *the Income Tax Act,* 1961, *for saving capital gain tax .....*

5. A few transactions have to be shown between M/S MEDICITY HOSPITAL AND DIOGANISTlCs CENTRE & M/S MEDICITY as advised by Sri. Venugopal, consultant for the company. The Directors have confirmed that a *few transactions* of *buying and selling* of *about Rs.200001- have been made between the two firms to the date for this purpose. Sri. Vinod Rao was briefed on the matter by Dr. Yusuf .... "*

9.8. The above extract clearly shows the intention of the assessee in forming a firm without any activity for the entire period of its existence, is only to avoid capital gain tax for the land introduced in the Indiana Hospital & Heart Institute Ltd. From the para 5 of the above minutes, it is ample clear that how the assessee has planned and executed the fraudulent entry in the books of accounts of the firm to show some activity in the firm.

9.9. Further, the extracts from the Minutes of Board Meeting held on 21.03.2008 is as follows:-

"1. Dr. Yusuf informed the Meeting that at present the Firm M/s Medicity Hospital and Research centre (deed of *partnership dt.2310312007) had* 86 *cents land in the name* of *the partners represented by Dr. Yusuf and Dr. AIi. Further* 39 *cents were in the name* of *the two partners and would be brought in shortly. And the remaining* 25 *cents were with Dr. Yusuf and Mr. Haneef (brother* of *Dr. Yusuf) who would be admitted into partnership. Thus the Partnership would have* 1.5 *acre land. This land will be required by the company for its TNDIANA HOSPITAL project for which ALIF INSTITUTE OF MEDICAL SCIENCES PRIVATE LIMITED was incorporated. The project is* of *Rs.* 50 *crare approximately* of *which the land value itself is about Rs.12 crore. For the purpose* of *bringing in this land, the partnership firm will be succeeded by the company by way* of *SUCCESSION AGREEMENT (which will be drafted by Vinod Rao. The land for the project will be acquired in this manner from the firm. The payment for the land will be made to the partners in the form* of *EQUITY SHARES in the company. To ensure compliance with provisions* of *section* 47 *(xiii)* of *the income-tax Act,1961, the proportion* of *the existing partners will need to be maintained in the company for* a *minimum period* of 5 *years ....."*

10. Analysis of the Minutes of the Meeting:

Date of the Meeting	Discussion in the meeting	Analysis & Remarks
19.12.2007	..... the partnership firm transfer to private limited co. (following IT and for avoiding capital gain with one year to private to public 86 cents land	These works clearly reflect that the partnership firm is formed nly to avoid

	purchase is already firm's property as per deed of partnership. Other properties to be transferred to firm change in consultation as March 1st 2008 & bring it into common stock. Finally from firm to Company final partnership deed constant amendment fresh deed business from January to March 31-03-2008 revalue the partner account to be created 01-04-2008 transfer to private ltd.	capital gains and the entire arrangement is pre-planned not for tax avoidance but for tax evasion. "To avoid capital gains 4 to 5 conditions are must". There words reiterate that firm is merely a device.
08.02.2008	- Partnership Firm holding land. It will be shortly taken over by the Company. Its *books are to close by end of Feb 2008 or mid March 2008. Till now there are very few transactions in it. Purchase/Sale of medicines and a few other transactions should be shown from 23/03/2007 (date of* formation of partnershyip) to 28/02/2008 for closing its books.	The word "Its books or to close by Feb-2008 or Mid March 2008" indicate the pre-planned nature of the device and meticulous planning to avoid capital gains tax. The words "Transactions should be shown from 23.03.2007 to 28.02.2008" are decided on 18.02.2008. These words indicate that the entries made in teh firm are pre-planned and meticulous to avoid the capital gains.
15.03.2008	It would be advisable if all this land is brought into the books of the Firm and all other adjustments such as bringing in of Hannef into the partnership be made by March 31, 2008, so as to enable succession of the firm by the Comapny and compliance with provisions of section 47(xii) of the Income Tax Act, 1961, for saving capital gain tax	The pre-planned discussion regarding the transactions to be shown reflect the books of accounts of the firm or predetermined in the paper to show some activity whereas no real business activity occur in the firm.

	A few transactions have to be shown between M/S. MEDICITY HOSPITAL AND DIOGANISTICs CENTRE & M/S MEDCITY.	
21.03.2008	The project is of Rs.50 crore approximately of which the land value itself is about Rs.12 crore. The payment for the land will be made to the partners in teh form of EQUITY SHARES in the company. To ensure compliance with the provisions of section 47(xiii) of the Income-tax Act, 1961.	The sale consideration value of the land is Rs.12 crores and a device is formed to transfer the land.

10.1. From the above tabular column it is amply evident that months of planning were undergone for the transfer of the land from individual to company through the firm as a device to evade the capital gains tax with proyisions u/s 47(xiii).

10.2. The reason for enacting section 47(xiii) by the finance Act of 1998 as seen from the notes on clause are:

"Under the existing provision of the I.T.Act, business organisations have definite tax implications. Transfer of assets attracts levy of capital gains tax. 'Similarly, carry forward of losses and that of unabsorbed depreciation are not available to successor business entities. However, in cases of amalgamation, capital gains tax, is not levied and losses and absorbed depreciation are allowed to be carried forward under certain conditions. The expert Group, in the draft Income-Otax Bill, has recognized the need to encourage business reorganizations when they are in consonance with the objective of economic development and are not merely device to secure tax advantage."

10.3. Thus the bill proposes to allow tax benefits in case of business reorganisation with the objective of economic development and does not allow to be used merely as a device to secure tax advantage.

In the given case, the Firm is merely used only as a device to secure tax advantage and hence, the capital gains needs to be taxed in the hands of the individual.

11. Relevant case laws and applicability:

11.1. As discussed in para 4.9 the facts of the case are clearly against the principles laid down by the Hon'ble Supreme Court in the land mark case of *McDowell and* Co. *Ltd. Vs CTO(1985)* 3 *SCC 320.*

11.2. In the case of Sunil Sidharth Bhai Vs CIT, it is reiterated that when the partnership firm has no real business or there is no real need for partnership firm, then pertinent considerations to be taken into regard when the ITO enters upon a scrutiny of transaction for in the task of determining whether a transaction sham or a device, he is entitled to penetrate the veil covering it and ascertain the truth.

11.3. Thus as per the discussion the firm is, by book the definition of the device as discussed in the para 6.2. Hence, the firm is nothing but an arrangement or a scheme or often an underhand contrivance to evade the capital gains.

11.4. Based on the above discussion, it is very clear that the actual cost of the land is Rs. 12 Crores and the assessee has made a colourable device of forming a paper firm and transferred the land to the company without paying the capital gain tax.

11.5. The above discussion clearly demonstrates the intention of the assessee to avoid capital gains using firm as a device. The circumstantial evidences are analyzed based on 'the principles as discussed para 7 and these evidences also reiterate that firm merely a device.

11.6. Thus, the "mens rea" of the assessee to evade capital gains is clearly demonstrated with circumstantial evidences as well as with seized materials. The land is transferred from individual to the company and the value entered in the books of the company is regarded as the sale consideration i.e., Rs. 12 Crores and the capital gains is computed accordingly.

12. Summarizing the findings:

12.1. The assessees Mr. Yusuf Kumble and Ali Kumble used the colorable devise of forming a non genuine Firm and adopting revaluation and conversion as accounting techniques for transferring property. The transfer of land from the individuals to the firm and from there on to the company and revaluing the same from the purchase cost of 1.275 Crore to the value of consideration received in kind in the form of shares in the company Mls Indiana Hospital & Heart Institute Ltd at Rs 13 Crore is nothing but again accruing to the assessees U/s 45(3) of the I.T. Act.

12.2. The overwhelming evidence in the form of minutes of Board meeting, non genuine activities of the firm and other documents like substantial gap in the registration of the so called firm have all been parts of a scheme which has the sole objective of evading capital gains tax and hence, the definition of colorable device has propounded by the supreme court is squarely applicable to these scheme. Therefore the nail needs to be pierced and the gain that is accruing to the assessees as the difference in the value of assets that the assessees have got in the company for the land that has been surrendered and the purchase cost of this land has to be brought to the tax of sec 45(3) of the Act.

12.3. The attempt by the assessee to seek shelter under 47(XIII) of the Act to show that the entire scheme amounts to a part IX transfer as described under the companies act also fails miserably as the basic conditions could not be fulfilled as Rs. 1 crore is reflected as advance received from Indiana Hospital and Heart Institute Ltd which in turn has been transferred to the accounts of Or Ali Kumble and Or Yusuf Kumble.This is evident from the fact that the assessees have received benefit in the form a loan asset in the books of the company in leiu of the land surrendered over and above the equity shares allotted to them in proportion to their capital in the so called firm.

12.4. Thus, as explained the capital gains is computed by taking value of the land entered in the books of the company as sale consideration and the purchase cost of the land in the individual hands as cost of acquisition."

4. After search and seizure operations, notice u/s. 153A was issued to respondent-assessee calling upon them to file return of income. The respondent-assessee filed return of income in response to notice u/s. 153A same as the return of income originally filed under the provisions of section 139 of the Act. Against the said return of income, the AO computed the long term capital gain in respect of land property contributed as capital contribution in the partnership firm known as M/s Medicity Hospital and Research Centre, which was subsequently converted into a going concern to a company by name, M/s Mangalore Indiana Hospital Pvt. Ltd. under provisions of Schedule IX of the Companies Act, 1956. The consideration for take over of the company was paid in the form of allotment of shares in the name of partners of the firm. This consideration was claimed to be exempt by the respondent-assessee, as there was no event of tax liability on account of conversion of firm into a company.

5. Subsequently based on that evidence found as a result of 132 action, the AO was of the opinion that respondent-assessee had adopted a tax planning for the purpose of tax avoidance and therefore brought to tax under the head capital gains by setting out the facts as extracted above.

6. On appeal before the CIT(Appeals), the CIT(Appeals) has allowed the appeal by the assessee by observing as under:-

> "The only issue in appeal is whether provisions of Capital Gains are attracted in mere revaluation of the land and if yes, in whose hands it needs to be taxed, individuals or the firm.
>
> In his detailed submission, the appellant has given counter argument on every argument of the A.O. on the issue of taxability as capital Gains, the learned counsel for the appellant sated that revaluation does not amount to sale and therefore the value adopted on revaluation cannot be equated with sale consideration. Revaluation of assets can not constitute income. In opinion also, the incidence of income arises on sale and not on revaluation. An assessee may revalue his assets any number of times, but when that assets is sold. In cost price shall be the original price of that asset as recorded originally in the books of accounts. There is no doubt about the fact that the land was purchased with an intention of starting a hospital, a hospital has been erected on the piece of land and the land has not been sold. The doctor brothers have not received any sale consideration. The firm was created and then converted into a company was a legal requirement and I do not find any legal infirmity in the same. As per the provisions of the Act, it the property introduced in the firm is sold, the cost of acquisition shall be the cost recorded in the books before revaluation. Therefore, in my opinion, since the land has not been sold only on revaluation and in absence of any consideration coming to the doctor brothers, no Capital Gain arise. The A.O. is directed to delete the additions made on this account. These grounds of appeal of the appellant is allowed accordingly."

7. Being aggrieved, the Revenue is in appeal before us in the present appeals.

8. The ld. DR vehemently contended before us that the respondent-assessee transferred the land at cost to the firm which was subsequently

revalued at a much higher value and the firm was taken over by company, M/s Mangalore Indiana Hospital Pvt. Ltd. Thus, the respondent-assessee by adopting tax planning has avoided payment of capital gains tax. He further contended that the very fact that the partnership deed of M/s Medicity Hospital and Research Centre was amended several times goes to prove that assessee has been avoiding the payment of capital gains tax by resorting to tax planning device. Therefore, he supported the order of the ld. Assessing Officer.

9. On the other hand, the ld. AR for the assessee submitted that when a firm was converted into a limited company under provisions of Schedule IX of the Companies Act, 1956, there was no taxful event as held by the Hon'ble Bombay High Court in the case of *CIT v. Texspin Engineering & Manufacturing Works, 344 ITR 544 (Bom)*.

10. We have heard the rival submissions and perused the material on record.

11. The only issue that arises for consideration in the present appeals is whether the AO was justified in making assessment of capital gains in respect of the land shown as capital contribution in the hands of the firm and the same was revalued subsequently in the hands of the firm and converted into a company under the provisions of Schedule IX of the Companies Act, 1956 in the proceedings u/s. 153A of the Act?

12. In the present appeals as the facts emanate from the order of assessment, it is clear that the AO based on partnership deed and minutes of the Board meeting of M/s Medicity Hospital and Research Centre, had inferred that respondent-assessee by resorting to tax planning avoided the tax liability arising on account of contribution of capital to the firm and on its subsequent sale to a limited company.

13. This issue can be decided without dwelling into the chargeability of capital gains on account of conversion of a firm into a company under the provisions of Schedule IX of the Companies Act, 1956. Now the law is quite settled that an assessment u/s. 153A can be made only based on the incriminating material found as a result of action u/s. 132 of the Act. In the present cases, the alleged incriminating material was in the form of partnership deed and minutes of the Board meeting. In our considered opinion, this material does not indicate any undisclosed income in the form of money, bullion or other valuable assets. It only indicates that the assessee adopted a tax planning device in order to escape the clutches of the provisions of section 45 of the I.T. Act. The legality or otherwise of these transactions can only be examined in the regular assessment proceedings. The minutes of the Board meeting of the said company or the partnership deep does not reveal that the

transactions *per se* is illegal or the transaction of conversion of firm into a company is *per se* illegal nor indicates any undisclosed income.

14. The Hon'ble jurisdictional High Court in the case of *CIT v. IBC Knowledge Park (P) Ltd., 385 ITR 346 (Kar)* held that when no material was found during the course of search indicating undisclosed income, no addition can be made based on the inference of undisclosed income under the provisions of section 153A and 153C of the Act. The relevant portion of the judgment is extracted below :-

> "**44.** Before considering the rival contentions, it is necessary to advert to the scheme of the Act regarding special procedure for assessment in cases of search. Sub-section (1) of Section 132 of the Act states that where the Chief Commissioner or any other officer mentioned therein having information in his possession, has reason to believe that inter alia, any person is in possession of any money, bullion, jewellery or other valuable article or thing (hereinafter referred to as "valuable assets" for the sake of convenience) and such valuable assets represents either wholly or partly income or property, which has not been, or would not be, disclosed for the purposes of the Act, then, the authorized officer can enter and search any building, place, vessel, vehicle or aircraft, where he has reason to suspect that such books of account, other documents, or valuable assets are kept or search any person, break open the lock of any door etc., seize any books of account, other documents, or other valuable assets found as a result of such search and do all other things necessary as prescribed under Section 132 of the Act.
>
> **45.** Sections 153A, 153B and 153C were inserted by the Finance Act, 2003, with effect from 1/6/2003. They have replaced the

post-search block assessment scheme in respect of any search or requisition made after 31/5/2003. Sub-section (1) of Section 153A inter alia deals with assessment in case of search or requisition. It begins with a non-obstante clause and states that notwithstanding anything contained in Sections 139, 147, 148, 149, 151 and 153, in the case of a person where a search is initiated under Section 132 or books of account, other documents or any valuable assets are requisitioned under Section 132A, the Assessing Officer shall issue notice to such person requiring him to furnish within such period, as may be specified in the notice, return of income in respect of each assessment year falling within six assessment years referred to in clause (b) of Section 153(1) in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed and the provisions of the Act shall, so far as may be, apply accordingly as if such return were a return required to be furnished under Section 139. The Assessing Officer can assess or reassess the total income of six assessment years immediately preceding the assessment year relevant to the previous year in which such search is conducted or requisition is made. However, assessment or reassessment, if any, relating to any assessment year falling within the period of six assessment years referred to in this sub-section pending on the date of initiation of the search under Section 132 or making of requisition under Section 132A, as the case may be, shall abate. The explanation states, save as otherwise provided in Sections 153A, 153B and 153C, all other provisions of the Act shall apply to the assessment made under Section 153A. Section 153B speaks about time-limit for completion of assessment under Section 153A.

46. 153C is relevant for the purposes of this case. Sub-section (1) of Section 153C begins with a non-obstante clause and it states that notwithstanding anything contained in Sections 139, 147, 148, 149, 151 and 153, where the Assessing Officer is satisfied that any valuable assets, seized or requisitioned, belongs to, or any books of account or documents, seized or requisitioned, pertains or pertain to, or any information contained therein, relates to a person other than the person referred to in Section 153A, then, the books of account or documents or valuable assets, seized or requisitioned shall be handed over to the Assessing Officer having jurisdiction over such other person and that Assessing Officer shall proceed against each such other

person and issue notice and assess or reassess the income of the other person in accordance with the provisions of Section 153A, if that Assessing Officer is satisfied that the books of account or documents or valuable assets seized or requisitioned have a bearing on the determination of the total income of such other person for the relevant assessment year or years referred to in sub-section (1) of Section 153A.

Sub-section (2) of Section 153C states that where books of account or documents or valuable assets seized or requisitioned as referred to in sub-section (1) has or have been received by the Assessing Officer having jurisdiction over such other person after the due date for furnishing the return of income for the assessment year relevant to the previous year in which search is conducted under Section 132 or requisition is made under Section 132A and in respect of such assessment year - (a) no return of income has been furnished by such other person and no notice under sub-section (1) of Section 142 has been issued to him, or (b) a return of income has been furnished by such other person but no notice under sub-section (2) of Section 143 has been served and limitation of serving the notice under sub-section (2) of Section 143 has expired, or (c) assessment or reassessment, if any, has been made, before the date of receiving the books of account or documents or valuable assets seized or requisitioned by the Assessing Officer having jurisdiction over such other person, such Assessing Officer shall issue notice and assess or reassess total income of such other person of such assessment year in the manner provided in Section 153A.

47. Chapter XIV-B consists of Section 158B to 158BH, inserted with effect from 01/07/1995, deals with special procedure for assessment in search cases. The Finance Act, 1995 inserted Chapter XIV-B in the Act, incorporating a new scheme of block assessment in cases relating to search conducted under Section 132 of the Act or requisitions made under Section 132A after 30/06/1995. Section 158B(b) defines 'undisclosed income' to include any money, bullion, jewellery or other valuable article or thing or any income based on any entry in the books of account or other documents or transactions, where such money, bullion, jewellery, valuable article, thing, entry in the books of account or other document or transaction represents wholly or partly income or property, which has not been or would not have been disclosed

for the purposes of this Act or any expense, deduction or allowance claimed under this Act which is found to be false. Section 158BA deals with assessment of undisclosed income as a result of search, while Section 158BB deals with computation of undisclosed income of the block period. Block period is defined in Section 158B(a) to mean the period comprising previous years relevant to six assessment years preceding the previous year in which the search was conducted under Section 132 or any requisition was made under Section 132A and also includes the period up to the date of commencement of such search or date of such requisition in the previous year in which the said search was conducted or requisition was made. The proviso is not relevant for the purpose of this case.

48. Section 158BD is relevant for the present case and it states that where the Assessing Officer is satisfied that any undisclosed income belongs to any person, other than the person with respect to whom search was made under Section 132 or whose books of account or other documents or any assets were requisitioned under Section 132A, then the books of account, other documents or valuable assets seized or requisitioned shall be handed over to the Assessing Officer having jurisdiction over such other person and that Assessing Officer shall proceed under Section 158BC against such other person and the provisions of Chapter XIV-B shall apply accordingly. Section 158BE prescribes time-limit for completion of block assessment. Section 158BH states that except as otherwise provided in Chapter XIV-B all other provisions of the Act shall apply to the assessment made under the said chapter. Section 153C provides for the role of the Assessing Officer having jurisdiction over the person searched/requisitioned as regards third party liability. The said section covers assessments which have become necessary, because of books of account, documents or valuable assets of third parties indicating their undisclosed income found during the search or requisition under Section 132/132A leading to a prima facie tax liability. A special procedure is contemplated in such cases. Such books of account, documents or valuable assets are required to be handed over by the Assessing Officer having jurisdiction over the persons searched requisitioned to the Assessing Officer of a third party on his satisfaction that they belong to a third party before handing over.

49. On a conjoint reading of the aforesaid provisions, it becomes clear that a search can take place only when a concerned officer has information and reason to believe that any person is in possession of any valuable assets, which has not been or would not be disclosed under the Act. In such a case, a search can take place. Following the search, if any books of account, other documents, any valuable assets is or are found in the possession or control of any person in the course of a search, then the books of account or other documents or valuable assets could be seized. Under Section 153A, the satisfaction regarding an inference of liability must be recorded. The Assessing Officer has to issue notice to the assessee i.e., the person searched for the purpose of assessment or reassessment of the total income of six assessment years immediately preceding the assessment year relevant to the previous year in which such search is conducted. Section 153C as already noted, deals with assessment of income of any other person, when the Assessing Officer is satisfied that the books of account or documents or valuable assets seized or requisitioned have a bearing on the determination of the total income of such other person for the relevant assessment year or years referred to under sub-section(1) of Section 153A of the Act. In such a case, the Assessing Officer has to issue notice to assess or reassess income of other person under Section 153A of the Act. Thus, the fact that search has been conducted would not justify issuance of notice under Section 153A. If it is only during a valid search when certain incriminating materials are detected, notice could be issued.

50. Chapter XIV-B which deals with special procedure for assessment of search cases deals with undisclosed income as a result of search, the computation thereof and such other provisions. Undisclosed income is defined in Clause (b) of Section 153B. Undisclosed income includes money, bullion or other valuable assets. It is only when the concerned officer has information about the same and has reason to believe that the said valuable assets has not been or would not be disclosed would give jurisdiction to the officer authorized to conduct a search operation. Therefore, the object and purpose of a search is to detect undisclosed income. As defined under Clause (b) of Section 158B of the Act, it is only when the undisclosed income is detected in a search operation that there would be assessment or reassessment, under the provisions of Chapter XIV-B of the

Act, of the person who is presumed to be in possession of the undisclosed income. If during the course of search, any valuable assets belongs to or any books of account or document seized or requisitioned pertains to or any information contained therein relates to a person other than the persons searched, then the Assessing Officer, on recording satisfaction, can also assess and reassess the income of any other person. Thus, what emerges is that the sine qua non for the purpose of assessment or reassessment pursuant to a search operation is detection of undisclosed income. In fact, the initiation of search proceeding is also based on possession of information and reason to believe that a person is in possession of certain valuable assets, which has not been or would not be disclosed under the Act. The same is nothing but 'undisclosed income' as defined in Clause (b) of Section 158B(b) of the Act. This becomes even more clear on a comparison of section 132(1)(c) with Section 158B(b) of the Act. It is for the above reason that Sections 153A and 153C begin with a non-obstante clause in order to make these provisions exclusive of Sections 139, 147, 148, 149, 151 and 153 of the Act. If a search operation does not lead to detection of undisclosed income as defined in Chapter XIV-B of the Act, then no purpose would be served in reopening the assessment already completed. Also, if there is no detection of any undisclosed income, then there would be no need for pending assessment to abate. Thus, when particulars of income declared in the return is already available with the Assessing Officer, such income cannot form part of undisclosed income even if such return is filed beyond the time-limit, but before search, as long as they relate to any year covered in the block. Thus, a block assessment is justified only on the basis of evidence found during search and the materials or information relatable thereto.

Section 153C is in *pari materia* with Section 158BD conferring jurisdiction over third parties to a search providing certain conditions before the Assessing Officer having jurisdiction over a third party can assume jurisdiction. Materials such as books of account, documents or valuable assets found during a search should belong to a third party which would lead to an inference of undisclosed income of such third party. Such an inference should be recorded by the Assessing Officer having jurisdiction over the searched persons and communicated to the Assessing Officer having jurisdiction over such third party along with the

seized documents and other incriminating materials on the basis of which the Assessing Officer having jurisdiction over such third party would issue notice under Section 153C. On receipt of the aforesaid material, the Assessing Officer having jurisdiction over such third party would proceed against the said third party. Thus, where no material belonging to a third party is found during a search, but only an inference of an undisclosed income is drawn during the course of enquiry, during search or during post-search enquiry, Section 153C would have no application. Thus, the detection of incriminating material leading to an inference of undisclosed income is a sine qua non for invocation of Section 153C of the Act.

51. Before considering the decisions cited at the Bar, it is necessary to refer to a decision of the Hon'ble Supreme Court in *Manish Maheshwari* v. *Asst. CIT* [2007] 289 ITR 341/158 Taxman 258. In that case, search was conducted on one of the directors of the assessee-company M/s. Indore Construction (Pvt.) Ltd. When the search was conducted in the premises of the director Sri. Manish Maheshwari and his wife several incriminating documents relating to the company were seized. While dealing with Section 158BD of the Act, the Hon'ble Supreme Court has observed as under:

> "Condition precedent for invoking a block assessment is that a search has been conducted under Section 132, or documents or assets have been requisitioned under Section 132A. The said provision would apply in the case of any person in respect of whom search has been carried out under Section 132A or documents or assets have been requisitioned under Section 132A. Section 158BD, however, provides for taking recourse to a block assessment in terms of Section 158BC in respect of any other person, the conditions precedents wherefor are : (i) Satisfaction must be recorded by the Assessing Officer that any undisclosed income belongs to any person, other than the person with respect to whom search was made under Section 132 of the Act; (ii) The books of account or other documents or assets seized or requisitioned had been handed over to the Assessing Officer having jurisdiction over such other person; and (iii) The Assessing Officer has proceeded under Section 158BC against such other person.

> The conditions precedent for invoking the provisions of Section 158BD, thus, are required to be satisfied before the provisions of the said chapter are applied in relation to any person other than the person whose premises had been searched or whose documents and other assets had been requisitioned under Section 132A of the Act."

In that case, it was held that the Assessing Officer had not recorded his satisfaction, which is mandatory; nor had he transferred the case to the Assessing Officer having jurisdiction over the matter. Therefore, the judgment of the High Court was set aside and the appeals were allowed.

52. The decisions relied upon by the learned Senior Counsel appearing for the assessee are as under:

(a) In *CIT* v. *Calcutta Knitwears* [2014] 362 ITR 673/223 Taxman 115 (Mag.)/43 taxmann.com 446 (SC), the Hon'ble Supreme Court considered the question, as to at what stage of the proceedings under Chapter XIV-B, the Assessing Authority was required to record his satisfaction for issuing notice under Section 158BD of the Act. In that case, the facts were that a search operation under Section 132 of the Act was carried out in two premises of the Bhatia Group, namely M/s. Swastik Trading Co., and M/s. Kavita International Co., on 5/2/2003 and certain incriminating documents pertaining to the assessee-firm i.e., Calcutta Knitwear were traced in the said search. After completion of the investigation by the investigating agency and handing over of the documents to the assessee to the Assessing Authority, the latter had completed the block assessments in the case of Bhatia group. Since certain other documents did not pertain to the person searched under Section 132 of the Act, the Assessing Authority therein thought it fit to transmit those documents, which according to him pertained to undisclosed income on account of investment element and profit element of the assessee-firm and required to be assessed under Section 158BC read with Section 158BD of the Act to another Assessing Authority in whose jurisdiction the assessments could be completed. In doing so, the Assessing Authority recorded his satisfaction note dated 15/7/2005. The

jurisdictional Assessing Authority for the assessee had issued show-cause notice under Section 158BD for the block period of six years dated 10/2/2006 to the assessee. The assessee had replied that no action could be initiated against the assessee and requested the Assessing Authority to drop the proceedings. The stand of the assessee was rejected by the Assessing Authority, who concluded the assessment proceedings under Section 158BD of the Act. It was also held that notice could be issued even after completion of the proceedings of the searched person under Section 158BC of the Act.

Aggrieved by the order of the Assessing Officer, the assessee therein had filed an appeal before the Appellate Authority, who had partly allowed the appeal. The Revenue had carried the matter further by filing an appeal before the Tribunal and the assessee therein filed cross-objection. The Tribunal rejected Revenue's appeal, which filed an appeal before the High Court, which also rejected the Revenue's appeal and confirmed the order of the Tribunal. The Revenue, then approached the Hon'ble Supreme Court. While dealing with various provisions of Chapter XIV-B of the Act pertaining to assessment in the case of search operation, the Hon'ble Supreme Court held that Section 158BD of the Act deals with undisclosed income of any other person. On the question of recording satisfaction that there is an undisclosed income, which had been traced where a person was searched under Section 132 of the Act or books of account, other documents or valuable assets are requisitioned under Section 132A of the Act, the Hon'ble Supreme Court opined as under:

"We would certainly say that before initiating proceedings under section 158BD of the Act , the Assessing Officer who has initiated proceedings for completion of the assessments under section 158BC of the Act should be satisfied that there is an undisclosed income which has been traced out when a person was searched under Section 132 or the books of account were requisitioned under Section 132A of the Act. This is in contrast to the

provisions of section 148 of the Act where recording of reasons in writing are a sine qua non. Under Section 158BD, the existence of cogent and demonstrative material is germane to the Assessing Officers' satisfaction in concluding that the seized documents belong to a person other than the searched person is necessary for initiation of action under Section 158BD. The bare reading of the provision indicates that the satisfaction note could be prepared by the Assessing Officer either at the time of initiating proceedings for completion of assessment of a searched person under Section 158BC of the Act or during the stage of the assessment proceedings. It does not mean that after completion of the assessment, the Assessing Officer cannot prepare the satisfaction note to the effect that there exists income-tax belonging to any person other than the searched person in respect of whom a search was made under Section 132 or requisition of books of account were made under Section 132A of the Act. The language of the provision is clear and unambiguous. The Legislation has not imposed any embargo on the Assessing Officer in respect of the stage of proceedings during which the satisfaction is to be reached and recorded in respect of the person other than the searched person.

Further Section 158BE(2)(b) only provides for the period of limitation for completion of block assessment under Section 158BD in case of the person other than the searched person as two years from the end of the month in which the notice under this Chapter was served on such other person in respect of search carried on after January 1, 1997. The said section does neither provide for nor impose any restrictions or conditions on the period of limitation for preparation of the satisfaction note under Section 158BD and consequent issuance of notice to the other person.

(c) In *Jai Steel (India)* v. *Asstt. CIT* [2013] 36 taxmann.com 523/219 Taxman 223 (Raj.), it was held that no doubt the Assessing Officer is free to disturb income, expenditure or deduction de hors any incriminating material, while

making an assessment under Section 153A of the Act. But in the context of a search, Section 153A to 153C cannot be interpreted to be a "further innings" for the Assessing Officer and/or the assessee beyond the provisions of Sections 139 (return of income); 139(5) (revised return of income); 147 (income escaping assessment) and 263 (revision of orders) of the Act.

It was also held that it was not open for the assessee to seek deduction or claim expenditure, which had not been claimed in the original assessment, which assessment already stood completed, only because a assessment under Section 153A of the Act in pursuance of search or requisition was required to be made.

(d) In *CIT* v. *Kabul Chawla* [2016] 380 ITR 573/[2015] 234 Taxman 300/61 taxmann.com 412 (Delhi), the Delhi High Court has held that (i) once a search takes place under Section 132 of the Act, notice under Section 153A(1) will have to be mandatorily issued to the person in respect of whom search was conducted requiring him to file returns for six assessment years immediately proceeding the previous year relevant to the assessment year in which the search takes place. (ii) Assessment and reassessments pending on the date of the search shall abate. The total income for such assessment years will have to be computed by the Assessing Officers as a fresh exercise. (iii) The Assessing Officer will exercise normal assessment powers in respect of the six years previous to the relevant assessment year in which the search takes place. The Assessing Officer has the power to assess and reassess the "total income" of the six years in separate assessment orders for each of the six years. In other words, there will be only one assessment order in respect of each of the six assessment years in which both the disclosed and the undisclosed income would be brought to tax. (iv) Although Section 153A does not say that additions should be strictly made on the basis of evidence found in the course of the search, or other post-search material or information available with the Assessing Officer which can be related to the evidence found, it does not mean that

> the assessment can be arbitrary or made without any relevance or nexus with the seized material. Obviously, an assessment has to be made under this section only on the basis of the seized material. (v) In the absence of any incriminating material, the completed assessment can be reiterated and the abated assessment or reassessment can be made. The word "assess" in Section 153A is relatable to abated proceedings (i.e., those pending on the date of search) and the word "reassess" to completed assessment proceedings. (vi) Insofar as pending assessments are concerned, the jurisdiction to make the original assessment and the assessment under Section 153A merges into one. Only one assessment shall be made separately for each assessment year on the basis of the finding of the search and any other material existing or brought on record of the Assessing Officer. (vii) Completed assessments can be interfered with by the Assessing Officer while making the assessment under Section 153A only on the basis of some incriminating material unearthed during the course of search or requisition of documents or undisclosed income or property discovered in the course of search which were not produced or not already disclosed or made known in the course of original assessment.

The Delhi High Court further held that in the cases before it on the date of the search the assessment already stood concluded since no incriminating material was unearthed during the search, no additions could have been made to the income already assessed. The questions were accordingly answered in favour of the assessee.

53. Learned counsel for the Revenue has relied upon the following citations in support of his contentions:

(a) In *Kamleshbhai Dharamshibhai Patel* v. *CIT* [2013] 31 taxmann.com 50/214 Taxman 558 (Guj.), on considering Section 153C of the Act, it was observed that the said section begins with a non-obstante clause. Requirements for assuming jurisdiction under Section 153C (1) are, that the Assessing Officer is satisfied that any valuable assets or books of account or document seized or requisitioned belongs to a person other than the person referred in section

153A of the Act. In such a case, he shall handover to the Assessing Officer having jurisdiction of such other person, the books of account or document or documents or valuable assets seized or requisitioned. That the valuable assets or books of account seized or documents seized or requisitioned should belong to a person other than a person referred in Section 153A of the Act.

(b) In *Filatex India Ltd.* v. *CIT* [2015] 49 Taxman 465/[2014] 49 taxmann.com 465 (Delhi), the court rejected the argument that during assessment under Section 153A additions had to be restricted or limited to incriminating material only, found during course of search.

(c) In *Savesh Kumar Agarwal* v. *Union of India* [2013] 35 taxmann.com 85/216 Taxman 109 (Mag.)/353 ITR 26 (All.), the question considered was whether on receipt of satisfaction note, the Assessing Officer had not found anything adverse against the assessee and seized goods having been released in favour of the assessee, notice could be issued under Section 153C of the Act to file returns for six years. The stand of the Revenue therein was that the Assessing Officer could still proceed under Section 153A of the Act in order to find out the source of income. In that case the writ petition filed under Article 226 of the Constitution of India challenging the notice was dismissed on the premises that the power under Section 153C exists in the Assessing Officer, if he is satisfied with regard to the need for examination of the source of income.

(d) In *Dr. K.M. Mehaboob* v. *Dy. CIT* [2012] 26 taxmann.com 54 (Ker.), it was held that unlike under Section 158BD, for transferring a file under Section 153C, there is no need to examine whether the books of account or other evidence or materials seized in the course of search of an assessee represents or proves undisclosed income of another assessee. On the other hand, for transferring the file to the Assessing Officer of such other assessee, all that is required to be considered is whether the materials or books of account or evidence recovered relates to another assessee, which may or may not lead to an assessment in the case of the other assessee after transfer of the file to his Assessing

Officer. This is only an internal arrangement to be made between two Departmental Officers and in this regard the only fact that needs to be verified is whether the assessee whose books of account or materials are recovered in the course of search of any other assessee, is a regular assessee before another Officer, and if so, to transfer the file to such other Officer for his consideration and for passing orders, whether assessment or penalty or such other order permissible under the Act by that Officer.

(e) In *Canara Housing Developnment Co.* v. *Dy. CIT* [2014] 49 taxmann.com 98 (Kar.), a Division Bench of this court in the said case noted that in the course of search, incriminating material leading to undisclosed income being seized, held that the block assessment roped in only the undisclosed income and the regular assessment proceedings were preserved, resulting in multiple assessments. Under Section 153A, however, the Assessing Officer has been given the power to assess or reassess the "total income" of the six assessment years in question in separate assessment orders. Once the assessment is reopened, the Assessing Authority can take note of the income disclosed in the earlier return, any undisclosed income found during search or any other income which is not disclosed in the earlier return or which is not unearthed during the search, in order to find out what is the total income of each year and then pass assessment order.

(f) Similarly, in *Gopal Lal Badruka* v. *Dy. CIT* [2012] 346 ITR 106/27 taxmann.com 167 (AP), the search revealed incriminating material and undisclosed income.

(g) in *SSP Aviation Ltd.* v. *Dy. CIT* [2012] 20 taxmann.com 214/207 Taxman 260 (Delhi), the observations of the court were in light of the fact that incriminating material had been found.

(h) In *CIT* v. *Anil Kumar Bhatia* [2012] 211 Taxman 453/24 taxmann.com 98 (Delhi), the court did not express any opinion as to whether Section 153 A can be invoked in a case where no incriminating material was found during the search as it was in fact dealing with a case where

incriminating material had been found.

54. On a consideration of the relevant sections as well as judicial precedent referred to above, what emerges is that, Section 158BD of the Act deals with undisclosed income of a third party. However, insofar as the incriminating material of the searched person or other person detected during the course of search is concerned, the same can be considered during the course of assessment. Further, such incriminating material must relate to undisclosed income which would empower the Assessing Officer to upset or disturb a concluded assessment of the other person. Otherwise, a concluded assessment would be disturbed without there being any basis for doing so which is impermissible in law. Even in case of a searched person, the same reason would hold good as in case of any other person. As observed by us, detection or the existence of incriminating material is a must for disturbing the assessment already made and concluded. But, at the same time, such can be at three stages: one, at the stage when the reassessment is initiated, the second, at the stage during the course of reassessment and third, at a stage where the reassessment is altered by a different assessment in respect of searched person or in respect of third party. In this regard, reference may be made to the decision of Apex Court in case of *M/s. Calcutta Knitwear* (*supra*) and based on the said decision, the CBDT has also issued circular dated 31.12.2015 vide No.24/2015.The relevant extract of the circular for ready reference can be extracted as under:

> 'The issue of recording of satisfaction for the purposes of section 158BD/153C has been subject matter of litigation.
>
> 2. The Hon'ble Supreme Court in the case of *M/s Calcutta Knitwears* in its detailed judgment in Civil Appeal No.3958 of 2014 dated 12.3.2014(available in NJRS at 2014-LL-0312-51) has laid down that for the purpose of Section 158BD of the Act, recording of a satisfaction note is a prerequisite and the satisfaction note must be prepared by the AO before he transmits the record to the other AO who has jurisdiction over such other person u/s 158BD. The Hon'ble Court held that "the satisfaction note could be prepared at any of the following stages:

(*a*) at the time of or along with the initiation of proceedings against the searched person under section 158BC of the Act; or (b) in the course of the assessment proceedings under section 158BC of the Act; or (c) immediately after the assessment proceedings are completed under section 158BC of the Act of the searched person."

2. Several High Courts have held that the provisions of section 153C of the Act are substantially similar/pari-materia to the provisions of section 158BD of the Act and therefore, the above guidelines of the Hon'ble SC, apply to proceedings u/s 153C of the IT Act, for the purposes of assessment of income of other than the searched person. This view has been accepted by CBDT.

3. The guidelines of the Hon'ble Supreme Court as referred to in para 2 above, with regard to recording of satisfaction note, may be brought to the notice of all for strict compliance. It is further clarified that even if the AO of the searched person and the "other person" is one and the same, then also he is required to record his satisfaction as has been held by the Courts.

4. In view of the above, filing of appeals on the issue of recording of satisfaction note should also be decided in the light of the above judgment. Accordingly, the Board hereby directs that pending litigation with regard to recording of satisfaction note under section 158BD/153C should be withdrawn/not pressed if it does not meet the guidelines laid down by the Apex Court.'

As per the aforesaid circular, at the time of or along with initiation of the proceedings, against the searched person or third party under Section 153C or in the course of assessment proceedings under Section 153C of the Act or immediately after the assessment proceedings are completed under Section 153C of the Act, recording of satisfaction is required.

55. If the observations made by the Tribunal are considered in this regard, it is noted by the Tribunal that it is not necessary that satisfaction should be recorded that documents or valuable assets found in the course of search showed undisclosed income. In view of the aforesaid discussion, we do not think that such can be

the correct position of law.

> **56.** Further, in the judgments referred to by the learned counsel for the Revenue, where incriminating material leading to undisclosed income of another assessee was detected in a search operation, in those cases, reopening of the concluded assessment have taken place. There has been no single decision cited by the learned counsel for the Revenue where the assumption of jurisdiction of the Assessing Officer is in the absence of any incriminating material or undisclosed income having been detected during the course of search leading to reopening of a concluded assessment. In the instant case, though documents belonging to the assessee were seized at the time of search operation, there was no incriminating material found leading to undisclosed income. Therefore, assessment of income of the assessee was unwarranted. Consequently, no satisfaction was recorded in the case of the assessee.
>
> We answer substantial question of law No.2 by holding that the Tribunal was not correct in holding that the assessment under Section 153C was valid despite there being no satisfaction recorded to the effect that the documents found during the search on 17/06/2008 were incriminating in nature and prima facie represented undisclosed income."

15. The ratio that can be culled out from the above decision is that assessment under the provisions of section 153A can be made or should be confined to the incriminating material found as a result of search and seizure action. As stated by us *supra*, in the present cases, the AO had not referred to any incriminating material which indicates that the tax planning adopted by the respondent-assessee is not legally permissible nor indicating any undisclosed income. These are all the public documents which are available for inspection by anybody and that cannot be called incriminating material. By no stretch of imagination these material can be

called incriminating material. The Assessing Officer had not recorded any satisfaction as to how the material found is incriminating in nature. Further no addition can be made in the assessment u/s. 153A based on inferences drawn from already disclosed / public documents found. This kind of issues can be examined only in the regular assessment proceedings. Therefore, the assessments made cannot be upheld in law as the additions have not been based on any incriminating material.

16. In the result, the appeals filed by the revenue are dismissed.

Pronounced in the open court on this 03rd day of May, 2017.

Sd/-	Sd/-
(SUDANSHU SRIVASTAVA)	(INTURI RAMA RAO)
Judicial Member	Accountant Member

Bangalore,
Dated, the 03rd May, 2017.

/ Desai Smurthy /

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar,
ITAT, Bangalore.