

IN THE INCOME TAX APPELLATE TRIBUNAL  
HYDERABAD BENCHES “B” SMC BENCH: HYDERABAD

BEFORE SHRI D. MANMOHAN, VICE PRESIDENT

ITA. No.923/Hyd/2016  
Assessment Year: 2007-2008

M/s. Veena Industries, No.30, IDA Balanagar, Hyderabad. PAN: AABFV 8957 A (Appellant)	vs.	Income Tax Officer, Ward-11(3), Hyderabad. (Respondent)
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For Assessee:	Shri G. Kalyandas
For Revenue :	Smt. N. Swapna, DR

Date of Hearing :	19.02.2018
Date of Pronouncement :	11.05.2018

**ORDER**

**PER D. MANMOHAN, VP.**

This appeal is filed at the instance of the assessee and it pertains to the Assessment Year 2008-2009.

2. Though the assessee raised several grounds – which were revised and re-revised – essentially they refer to two issues i.e., computation of capital gains and disallowance of interest. Facts in brief are set out below.

3. Assessee firm is engaged in the business of manufacture of fan components and fibre glass components. For the year under consideration it declared business loss of Rs. 14,85,414/- and long term capital loss of Rs. 22,02,277/-. Though the return was originally processed u/s 143(1) of the Act, it was later on taken up for scrutiny and details were called for. During the course of examination it was noticed that the assessee sold a piece of land admeasuring 954 sq. yards

out of 2420 sq. yards for a consideration of Rs. 25,20,000/-. The assessee claimed long term capital loss of Rs. 22,02,277/- on the aforesaid transaction. On verification it was noticed that the cost of acquisition of 2420 sq. yards was adopted by the assessee at Rs. 31,68,080/- by revaluing since the cost of the land as per the balance sheet as on 31.03.1997 was Rs. 1,08,467/-.

4. It may be noticed that the land was allotted by APIIC in the industrial area, for industrial purposes, to M/s. Veena Industries, which was a proprietary concern of Smt. C. Rajkumari. Possession of the land was delivered to her by APIIC on 28<sup>th</sup> November, 1973. The business was run as a proprietary concern in the said premises. The said concern was converted into a partnership firm on 01.04.1986 which consists of four persons. In other words, the proprietrix had taken three more persons and constituted a partnership firm and the land was utilised by the said firm since the firm succeeded to the business of the proprietary concern. Vide partnership deed dated 17.04.1986 it was declared that the business run in the name and style of M/s. Veena Industries, as a proprietary concern, was converted into partnership firm by including Shri O.P. Jaswal, Shri K.L. Jaswal and Shri S.P. Jaswal as partners since the proprietrix is desirous of increasing business and to reduce her share of burden of work. In the partnership deed it was also mentioned (vide page 7 of the paper book) that the business shall be deemed to have commenced on and from 01.04.1986 and the capital required for the partnership business shall be contributed by all the parties as and when required for the business and the net profit / loss of the partnership business shall be in the proportion of 52% to Smt. C. Raj Kumari and 16% each to the other three partners.

5. The case of the assessee was that M/s. Veena Industries was allotted land on 20.11.1973 and it was enjoying the absolute ownership

from that day onwards and firm merely succeeded to the business. **In the year 1986, the business was taken over by partnership firm.**

6. The Assessing Officer observed that the land was not allotted to the firm but to Smt. C. Raj Kumari in her capacity as proprietrix. Hence the date of possession by Smt. C. Raj Kumari cannot be considered as the date of possession of land to the assessee-firm. He further observed that upon conversion of proprietary concern to a partnership firm the land has become an asset of the firm and that could be said to be the date of possession of the firm. The firm having been formed w.e.f 01.04.1986, this could be the date of transfer of land. Since the cost of the property recorded in the balance sheet of the assessee, as on 01.04.1986, the same has to be taken as the cost of acquisition in the hands of the assessee-firm. Accordingly, Assessing Officer revalued the long term capital gains and arrived at Rs. 23,61,816/-.

7. On perusal of the interest debited to the Profit & Loss Account it is noticed that a sum of Rs. 1,70,000/- is paid towards interest on a loan availed from Smt. Rashmi Chakravarthi, amounting to Rs. 26 lakhs. This amount was advanced to Sri K.L. Jaiswal and Sri S.P. Jaiswal. Since no interest was received from the aforementioned persons, the interest debited to the Profit & Loss Account was disallowed by the A.O.

8. Aggrieved, assessee contended before the Ld. CIT(A) that working of capital gains as well as the disallowance of interest are bad in law. With regard to determining the capital gains, the assessee contends that the proprietary business was converted into partnership firm by induction of three persons which amounts to continuation of business upon succession in which event the fair market value of the land as on 01.04.1981 should be taken into consideration. With regard to the

disallowance of interest, the claim of the assessee is that notional interest was sought to be considered which is not permissible in law. It was contended that the amount was paid to Sri K.L. Jaiswal and Sri S.P. Jaiswal in respect of acquisition of property and income from the said property was admitted to tax and therefore, disallowance of notional interest is not called for.

9. Before the Ld. CIT(A) assessee contended that a part of the land, which was sold during the year under consideration, was allotted to M/s. Veena Industries on 20.11.1973 and the same business continued by the firm by way of succession by inducting three more persons as partners in which event the cost of acquisition would be the cost as on 20.11.1973, in which event fair market value of the land as on 01.04.1981 has to be adopted for determining the capital gains. It was also submitted that the fair market value as per the Registered Valuers report was Rs. 500/- per square yard.

10. Ld. CIT(A) observed that the proprietary concern and partnership concern are two different entities. The land was originally allotted by Andhra Pradesh Industrial Infrastructure Corporation (APIIC) to M/s. Veena Industries, a proprietary concern of Smt. C. Raj Kumari. The possession was delivered to her on 28.11.1973 and the business was carried on in this premises. After more than ten years Smt. C. Raj Kumari wanted to convert proprietary concern into partnership firm by introducing three more persons as on 01.04.1986. Thus the land can be said to have been freshly purchased by four persons namely Smt. C. Raj Kumari, Shri O.P. Jaswal, Shri K.L. Jaswal and Shri S.P. Jaswal, all being partners of the firm, which has come into operation by virtue of the partnership deed dated 17.04.1986 and they purchased the land vide the deed of sale dated 07.08.1990. Page 1 to 5 of the paper book is the registered sale deed which clearly shows that APIIC has given the land to the above mentioned four persons, who formed a partnership

firm. In fact vide page 3 it was stated that the firm has made an application for allotment of the plot and APIIC, being successor of the said land and competent to sell the said property, accordingly entered into agreement with the firm. According to the Learned Commissioner (Appeals), the sale deed clearly indicates that the land was purchased by the partners on behalf of the firm in 1990 itself and it cannot be said that the asset was passed on from Smt. C. Raj Kumari to the firm. He further observed that the Assessing Officer has in fact adopted the value as on 01.04.1981 for the purpose of computing the cost of acquisition as against the actual date of purchase i.e., 07.08.1990 which resulted in under-assessment of capital gains; on adoption of the value as on 07.08.1990 the capital may increase. Accordingly, the assessee firm was show caused as to why the computation of capital gains should not result in an enhancement. In reply thereto, the assessee submitted that vacant position of the land was allotted to Smt. C. Raj Kumari on 20.11.1973 on which factory building was constructed and the same was brought on record in the sale deed executed by APIIC on 07.08.1990 vide clause 6 of the registered sale deed (document No.3235 of 1990). Thus it was only the continuation of the possession of the property. Though the land was originally allotted to Smt. C. Raj Kumari in 1973 but later on formal sale deed was entered into in 1990 in the name of the partnership firm. It was strongly submitted that there is succession to the business with induction of three more partners, without disturbing the identity and continuity of the business, in which event the cost of the asset in the hands of the assessee should be taken as a cost at which it was first allotted i.e., on 20.11.1973. In this regard, assessee relied upon the decision of the Apex Court in the case of ED Sassoom & Co. Ltd (86 ITR 757) (SC). Reliance was also placed upon another decision of the Hon'ble Supreme Court in the case of CIT vs. K.H. Chambers (55 ITR 674 at 680-681) wherein the Court considered

the provisions of section 170 of the I.T. Act, 1961 to hold that if a business was taken over as a going concern, it implies that the identity and the continuity of the business is preserved. Reliance was also placed upon the decision of the Hon'ble jurisdictional High Court in the case of P. Koteswar Rao (46 ITR 882) (AP).

11. In short, the case of the assessee was that so long as the identity and continuity is proved, it amounts to succession to the business though the business was converted into partnership firm from 01.04.1986. Under section 55(2)(b) of the I.T. Act, 1961 the fair market value of the asset has to be determined at the option of the assessee, if the acquisition of the asset is before 01.04.1981. Accordingly it was contended that the fair market value of the property, as determined by the Registered Valuer, has to be taken into consideration. It was also submitted that u/s 14 of the Indian Partnership Act, once the property was succeeded - from proprietary concern to partnership firm - in the course of business, the property becomes the asset of the partnership firm.

12. Ld. CIT(A) referred to clause 7 of the agreement of sale to highlight that the first party is APIIC, who has agreed to sell the property to the assessee-firm at a consideration of Rs. 15,000/-. In other words, the land under reference can be said to have been purchased by four partners on 07.08.1990. The said sale was in fact preceded by an agreement of sale dated 03.07.1990. He further observed that the assessee sold 952 square yards out of the said land by virtue of a deed of sale dated 15.06.2006 wherein it was stated that the total land of 2420 square yards was purchased by M/s. Veena Industries represented by its partners vide the sale document No.3235/1990 which supports the fact that the land was purchased by the partners on behalf of the firm and there is no indication therein to prove that the said asset was handedover by Mrs. C. Raj Kumari to the firm by

acquiring the same in the year 1973, enabling the firm to succeed to the property. He extensively referred to the sale deed to point out that there was a clear cut agreement between APIIC and the partnership firm wherein it was stated that APIIC has complete control over the property which has in turn sold the land, free from all encumbrances, to the partners - who are referred to the party of the second part - for a consideration of Rs. 15,000/-. Thus, the land could be said to have been purchased only on 07.08.1990.

13. He referred to the provisions of section 49(1) and section 55(2)(b) of the Act to highlight that the base year should be the first year in which the asset was held and in the instant case asset was purchased only on 07.08.1990. Accordingly, the A.O. was directed to compute the capital gains by working out cost of indexation method by adopting cost as on 07.08.1990.

14. With regard to the second issue, the contention of the assessee was that the assessee received amount from Smt. Rashmi Chakravarthi which was paid to Sri K.L. Jaiswal and Sri S.P. Jaiswal for acquiring a house. Though it was paid towards sale consideration, sale deed was executed later and rent received on the property was offered to tax in the next year. Thus, it is not a diversion of income for other purpose.

15. The Ld. CIT(A) did not take note of the contention of the Learned Counsel for the Assessee though it was categorically mentioned in para of the statement of facts and in Ground No.7 Ld. CIT(A) merely observed as under:

*“Ground No.7: The Assessing Officer on examination of profit and loss account, found that the assessee had debited Rs. 1,70,000/- as interest payment on loan availed from Smt. Rashmi Chakravarthi amounting to Rs. 26 lakhs. The said loan was advanced to Sri K L Jaiswal and Sri S P Jaiswal. Even though the assessee has availed interest-bearing loan from Smt. Chakravarthi, no interest was charged from Sri K L Jaiswal and Sri S P Jaiswal. Therefore, I hold that A.O. is justified in making disallowance of the interest. Thus, Ground number 7 is dismissed.”*

Further aggrieved, assessee is in appeal before the Tribunal.

16. Learned Counsel for the Assessee adverted my attention to section 55(2)(b) r.w.s 49(1) of the Act to contend that the fair market value of the asset as on 1<sup>st</sup> day of April, 1981 or the cost of acquisition, at the option of the assessee has to be taken into consideration when the asset becomes the property of the assessee by way of any of the modes prescribed in section 49(1), and if the said capital asset became the property of the previous owner before the 01<sup>st</sup> day of April, 1981, the assessee is entitled to take into consideration the cost of the capital asset to the previous owner or the fair market value of the assessee on the 01<sup>st</sup> day of April, 1981, which ever is more beneficial to the assessee. He has submitted that the fair market value as on 01.04.1981 is supported by Registered Valuers report which is not questioned by A.O. and hence the value specified in that report has to be taken into consideration.

17. Section 49(1) refers to a property which has been taken over by other concern by way of 'succession', 'inheritance' or 'devolution'.

18. Learned Counsel for the Assessee adverted my attention to the sale deed and agreement of sale entered into between the APIIC and the partnership firm to highlight that but for the continuance of the business the property, which was originally in the occupation and control of Smt. Raj Kumari, the assessee firm would not have been entitled to obtain the property by way of sale deed - which was only to formalise the possession i.e., vesting the possession in the hands of the firm. He contends that the sale deed should not be read in isolation and it has to be read by looking at all the clauses in totality. Vide clause-6 of the agreement of sale it was stated that the vacant possession of the land was delivered to the party of the second part on 20<sup>th</sup> September, 1973 and the party of the second part has constructed

the factory building and carried on business of production of assembly of ceiling fans on job work, which implies that the emphasis is more on the concern by name M/s. Veena Industries rather than on the constitution of the persons who are manning the business. It is a fact that the factory buildings were constructed at the cost of the proprietrix at the relevant point of time but ownership was formalised in 1990, in the name of the firm / 4 persons named through the abovementioned deed. The first party of the second part i.e., Smt. Raj Kumari was not paid any amount by APIIC which indicates that the possession was already given to M/s. Veena Industries in 1973 and in 1986 there was a mere succession of business of M/s. Veena Industries from the proprietary concern to partnership firm, in which event provisions of section 55(2)(b) r.w.s 49(1) of the Act comes into play. He referred to the decision of the Supreme Court in the case of E.D. Sassoom & Co. Ltd., (86 ITR 757) to submit that if an assessee takes over the business of predecessor of a going concern, it amounts to 'succession of the business' falling within the meaning of section 49(1) in which event the cost of the previous owner has to be taken into consideration. Section 170 of the Act was also referred to contend that when a person is carrying on a business and that has been succeeded by any other person and continues to carry on that business, it can be considered as a 'succession to business'. Though the said section was with reference to income assessable to tax in the hands of the previous owner and if the predecessor cannot be found it is to be assessable separately and recoverable from the successor. Learned Counsel for the Assessee refers to the aforementioned provisions to highlight that the Legislature, in its wisdom, has given more weightage to the succession of business rather than the mode for constitution i.e., whether transfer from a person to any firm or company and thus even for the purpose of levy of capital gains, the same analogy has to be taken into consideration. He

also submitted that in the case of CIT vs. K H Chambers (55 ITR 674) the Hon'ble Supreme Court observed "succession" connotes transfer of ownership so long as the integrity of the business remains and the whole business devolves upon the successor and the same business is continued by the person who succeeded. This appears to be a case concerned with the transfer of property of one firm to the another firm. However, the copy of the said decision is not placed before me. Learned Counsel for the Assessee also relied upon a decision of the Hon'ble jurisdictional High Court in the case of P. Koteswar Rao (46 ITR 882) wherein the issue of succession has come up for consideration i.e., upon death of a person whether there is succession to the business has to be decided subject to satisfaction of the following conditions"

- (a) Change of ownership;
- (b) Continuity in the integrity of the business and
- (c) Identity and continuity of the business in the hands of the person succeeded and the person succeeding.

19. Learned Counsel for the Assessee submits that in the peculiar circumstances of the case, it can be said to be transfer of Industrial Plot by proprietary concern to partnership firm, by way of succession, in which event the cost as on -01.04.1981 has to be taken into consideration. It was also contended that nominal charges were collected by APIIC, on registering sale deed in 1990, by admitting that possession of land was given to M/s. Veena Industries in 1973.

20. With regard to the disallowance of claim of deduction of interest paid on the borrowals, Learned Counsel for the Assessee submitted that there is no finding by the Tax Authorities that the loan was not taken for business purposes and in fact the only ground on which the A.O. disallowed the interest was that the assessee has not collected interest from the persons to whom the money was advanced, overlooking the fact that the money was not advanced to Sri S P Jaiswal and Sri K L

Jaiswal as a loan but it was an advance towards purchase of the property and the firm in fact owned the property and rents received therefrom were offered to tax in the subsequent year. Learned Counsel for the Assessee submitted that this aspect was overlooked by the A.O. as well as the Ld. CIT(A).

21. On the other hand, Learned Departmental Representative relied upon the orders passed by the Tax Authorities and it was submitted that the case law relied upon by the assessee are distinguishable on facts. The cases referred to by the assessee were pertaining to succession simpliciter i.e., where the same property, which was owned by predecessor assessee, was passed on to the successor assessee, whereas in the instant case, the sale deed between APIIC and the partners upon payment of Rs. 15,000/- towards purchase consideration by the firm leaves no doubt that it was a case of purchase of property from APIIC by the assessee-firm, as otherwise there was no need for making payment of Rs. 15,000/- by the firm.

22. I have carefully considered the rival submissions and perused the record. No doubt, the Learned Counsel for the Assessee relied upon several decisions with regard to the expression "succession" but the issue as to whether it was a case of succession or not depends upon the facts of each case. In the instant case, no doubt M/s. Veena Industries, as a proprietary concern carried on the same business which was succeeded by the assessee-firm and to that limited extent it can be said that the firm succeeded to the proprietary concern. But it is intriguing to note that the sale deed categorically mentions that APIIC is the owner of the said land and in fact the sale deed prescribes Rs. 15,000/- as a sale consideration towards cost of the land, including development charges. Since this land cannot be utilised for any other purposes other than for industrial purposes, probably the land cannot be transferred / passed on from the previous possessor to the partnership firm and

therefore, there was a need for the assessee-firm to purchase the land, free from all encumbrances, from APIIC. In other words, the land can only be allotted to persons who are engaged in the activity of manufacture or intended to carry on the old business. In a nutshell, the vacant land cannot be said to be the land owned by the previous owner. The Learned Counsel for the Assessee relied upon several case law which only speaks of succession of business and they do not refer to a specific land which was previously in the possession of M/s. Veena Industries proprietary concern as a licence holder but it has no rights to transfer the said land, whenever there was a change of constitution. In the instant cases, the land appears to have been handed over to the partners collectively by virtue of a sale deed entered into in 1990, on payment of Rs. 15,000/- only. We are only concerned with the value of the land and not with regard to the structures which are constructed by the previous occupant of the said land. In order to appreciate as to whether APIIC has a right to withhold the property from a manufacturer whenever there is a change of the constitution of the Members manning the business, one has to refer to the rules prescribed thereunder but nothing has been placed before me except the sale deed which merely indicates that though the vacant possession was delivered to M/s. Veena Industries (earlier owned by proprietary concern) on 20.11.1973, the same M/s. Veena Industries had to purchase the property by reconstituting itself as a partnership firm, for a sum of Rs. 15,000/-. Under these circumstances, I am of the view that the order passed by the Ld. CIT(A), on this aspect, does not call for any interference. Since cost as on 07.08.1990 has to be taken into consideration, the other contentions of the assessee regarding fair market value as on 01.04.1981 etc., need not be considered.

23. As regard the issue of disallowance of interest payable to Smt. Rashmi Chakravarthi, the assessee categorically states that it was

utilised for purchase of house property and the rent received from the said property was offered to tax in the hands of the firm. However, the agreement of sale as well as the sale deed shows that it was represented by its partner Smt. Sujata Jaiswal and Smt. Sashi Jaiswal, who are not referred to as partners in the deed dated 17.04.1986. Since the assessee claims that the rent was offered to tax in the hands of the firm, the same requires verification and if the amount is offered to tax by the firm and taxed accordingly, there is no case for disallowance of interest. Therefore, I hereby set-aside this issue to the file of the Assessing Officer to verify the same and reconsider the issue in accordance with law.

24. In the result, appeal filed by the assessee is treated as allowed for statistical purposes.

Order pronounced in the open court on 11<sup>th</sup> May, 2018.

Sd/-

**(D. MANMOHAN)**  
**VICE PRESIDENT**

Hyderabad, Dated: 11<sup>th</sup> May, 2018.

OKK, Sr.PS

Copy to

1.	M/s. Kalyandas & Co., Chartered Accountants, 15, Venkateshwara Colony, Narayanaguda, Hyderabad – 500 029.
2.	Income Tax Officer, Ward 11(3), Hyderabad.
3.	CIT (A)-5, Hyderabad.
4.	Pr. Commissioner of Income Tax-5, Hyderabad.
5.	DR, ITAT, Hyderabad.
6.	Guard File