

IN THE INCOME TAX APPELLATE TRIBUNAL "C" BENCH KOLKATA

आयकर अपीलीय अधीकरण, न्यायपीठ - "C" कोलकाता,

**BEFORE SHRI SANJAY GARG, JUDICIAL MEMBER
AND SHRI GIRISH AGRAWAL, ACCOUNTANT MEMBER**

**ITA No.2004/Kol/2018
Assessment Year: 2013-14**

Deputy Commissioner of Income-tax, Circle-10(1), Kolkata.	Vs	M/s. BHP (1981) Pvt. Ltd. AT Garia Station Road, Kolkata-700084 (PAN: AABCB1909M)
(Appellant)		(Respondent)

Present for:

Appellant by : Smt. Nibedita Gupta, Addl. CIT, DR

Respondent by : Shri S. S. Gupta, AR

Date of Hearing : 14.07.2022

Date of Pronouncement : 12.10.2022

ORDER

PER GIRISH AGRAWAL, ACCOUNTANT MEMBER:

This appeal by the revenue is arising out of the order of Commissioner of Income-tax(Appeals) – 4, Kolkata in appeal number 80/CIT(A)-4/2016-17 dated 21.06.2018 against the assessment order passed under section 143(3) of the Income-tax Act, 1961 (hereinafter referred to as the Act) by DCIT, Circle – 10(1), Kolkata, dated 16.03.2016.

2. Brief facts of the case are that assessee is a private limited company engaged in the business of manufacturing of pharmaceutical goods. Return of income was filed on 29.09.2013, reporting total income of Rs.33,00,927/-. During the year under consideration, assessee had sold a piece of land having an area of 120.5 cottahs (more than 6 bighas) and tin shed structure on it, to one S.R. Trexim Pvt. Ltd. on 18.03.2013 vide registered sale deed. Market value of the said property on the date of execution of sale through registered deed was assessed at

Rs.7,64,99,960/- by registering authority for the purpose of stamp duty. The said piece of land was conveyed in favour of the assessee on 31.07.2007 for Rs.85,72,068/-with further addition (improvements) of Rs.55,64,298/- made during the same year. Thus, the total value of the property was accounted at Rs.1,41,36,366/- (Rs.85,72,068 + Rs.55,64,298) in the books of accounts of the assessee for FY 2007-08 relevant to AY 2008-09. On 31.03.2008, assessee converted the said capital asset into stock-in-trade and reported the same as part of its stock-in-trade in its audited balance sheet as at 31.03.2008.

2.1. In the course of assessment, Ld. AO enquired about the transaction of sale of this property seeking the following details (as reproduced in the order): –

“1. Please furnish the Audit report and Tax Audit report with accounts and balance sheet (If every year from the year in which you have purchased the Land at Cossipore and sold during this year i.e. F.Y.2012-13.

2. Furnish the certified copy of both obverse and reverse side of purchase deed of Land at Cossipore.

3. Please confirm whether the said land has ever been included in assets or not? If the same has been included in assets then mention the year with date of conversion of such asset in stock-in -trade.

4. Furnish the item wise Trading accounts including purchase, sales, closing stock, and opening stock of each year starting from the year in which the Land at Cossipore has been purchased.

5. How many lands and buildings you have actually purchased for your trading business since the year in which such land has been purchased first to till this date?

6. Copy of Memorandum of Association & Articles of the Company.”

2.2. Assessee replied to the show cause letter of the Ld. AO by furnishing the following details vide letter dated 09.03.2016 placed in the paper book at page 57-58 (as reproduced in the order): –

“1. Audit Report and the Tax audit report for the assessment year 2008-09 is attached in which the land property was registered in favour of the company and converted into stock in trade at cost. The same was sold during the financial year 2012-13.

2. Photocopy of Purchase deed of the aforesaid property is attached.

3. The said land property was previously held as assets and converted as stock in trade as on 31-03-2008.

4. Regarding the requirement of item-wise trading account, purchase, sale, closing stock and opening stock, your kind attention drawn to the fact that the company has already discontinued its business and has no- staff and the task of preparing the details will also require hiring of personnel and also good deal of time. Therefore, your- good self is requested to advise accordingly.

5. The aforesaid property is the only property since then which held s stock in trade.

6. Photocopy of Memorandum of association & Articles of association is attached.”

[emphasis supplied by us by bold and underline]

2.3. From the perusal of the details furnished by the assessee, Ld. AO noted that there was no clause of doing any business like dealing in land and building, promoting of building construction, contained in the object clause of the Memorandum and Articles of Association of the assessee. Upon enquiry by the Ld. AO on this aspect, assessee submitted that a special resolution was passed by the members of the assessee company to do real estate business based on which the property sold during the year was treated as stock in trade since AY 2008-09. To substantiate this claim, assessee could not produce receipted copy of challan filed with ROC as it was not traceable by the assessee.

2.4. Considering the above submissions made by the assessee, Ld. AO observed that assessee has not dealt with any other land and building except with the impugned land since its inception. Ld. AO also noted that assessee could not furnish any registered or duly approved Memorandum and Articles of Association by the Registrar of Companies incorporating the objectives for carrying out the business of dealing in land and building, promoting of building construction, which was not incorporated in the object clause initially. Accordingly, Ld. AO

completed the assessment by treating the impugned property as capital asset instead of treating it as stock in trade as done by the assessee. Ld. AO rejected the claim of the assessee on sale of land with tin shed as stock in trade as part of business income. Based on the conclusion drawn by the Ld. AO, he computed the long-term capital gain by applying the provisions of section 50C read with section 2(14) of the Act as under: –

Cost of land in 2006-07	Rs. 85,72,068/-
Add: cost of improvement	<u>Rs. 55,64,298/-</u>
Total	Rs.1,41,36,366/-
Indexed cost (A)	Rs.2,31,68,510/-
Fair Market Value for the purpose of stamp duty (B)	Rs.7,64,99,960/-
Long Term Capital Gain (C = B - A)	Rs.5,33,31,450/-

2.5. Since the assessee has offered income from sale of impugned property as business income by treating it as stock in trade, ld. AO gave credit for the amount of business income of Rs.87,11,258/-by reducing it from the business income declared by the assessee to compute the assessed total income for the year.

2.6. In the alternate, ld. AO also calculated short-term capital gains on the impugned transaction of sale of land with tin shed under section 45(2) of the Act for an amount of Rs.3,01,58,310/-. In this respect, ld. AO noted that the benefit of deduction of asset value converted into closing stock from the business income of this year cannot be allowed if the provisions of section 45(2) of the Act are applied because in the process, the income of the assessee in the year of sale is divided into two parts viz., (i) calculation of capital gain under section 50C in the year of conversion; and (ii) business profit according to the book value taken by the assessee in the year of conversion. But by holding that the assessee may not be taxed twice in different ways, for the similar

income, ld. AO instead of going ahead with this alternative, resorted to making an addition by treating the impugned transaction as sale of capital asset by applying the provisions of section 50C of the Act and made the addition of Rs.5,33,31,450/- in completing the assessment.

2.7. Ld. AO also noted that assessee has made investment in shares of associate and other companies amounting to Rs.50,50,000/- and has incurred interest expense of Rs.26,38,958/- during the year, for which no disallowance has been made by the assessee under section 14A of the Act. Ld. AO computed the amount of disallowance by applying the provisions of rule 8D rws 14A of the Act, totalling to Rs.2,08,690/-. Aggrieved, assessee went in appeal before the ld. CIT(A).

2.8. Before the Ld. CIT(A), assessee submitted that conversion of investment made in the impugned property into stock in trade is bonafide in terms of clause number 6, 11 and 18 forming part of incidental objects contained in the Memorandum and Articles of Association and also in terms of resolution passed by the assessee and the disclosure made in the audited financial statement for the year ending on 31.03.2008. Further, it was submitted that the said conversion had been accepted by the Department in scrutiny assessment made under section 143(3) of the Act for AY 2012-13.

2.9. On the alternative approach adopted by the Ld. AO in respect of applying the provisions of section 45(2) of the Act, assessee submitted that Ld. AO tried to compute the long-term capital gain on the date of conversion i.e. 31.03.2008, as per section 45(2) by computing the fair market value on the basis of back calculation of stamp duty value as on 22.01.2011 by using year-wise cost inflation index, which is invalid and bad in law. It was also submitted by the assessee that Ld. AO should have referred the matter for determination of fair market value as on 31.03.2008 to the DVO which was not done. Assessee also submitted

that cost inflation index is used for the purpose of computing indexed cost of acquisition and not for determination of fair market value of the capital asset. Thus, on this alternative approach, assessee submitted that the computation of income and consequential tax liability ought to have been computed by invoking the provisions of section 45(2) of the Act for calculating long-term capital gain up to the date of conversion of the impugned property into stock in trade, on the difference between fair market value as on the date of conversion and indexed cost of the asset so converted and also for calculating business income, the difference between sale consideration of the stock in trade sold in the year under appeal and the fair market value of the same as on 31.03.2008.

2.10. For the ascertainment of fair market value as on 31.03.2008, assessee submitted that such fair market value can be determined by the approved valuer or by reference to the DVO. The other way is to adopt the stamp duty value of the property on such date. It was submitted by the assessee that the stamp duty value as on the date of purchase i.e. on 31.07.2007 in respect of the said property was determined by the registrar at Rs.81,96,944/- and therefore the amount of Rs.4,51,41,700/- adopted by the Ld. AO as the fair market value as on 31.03.2008 is arbitrary and unlawful. Assessee stated that it also does not have the stamp duty value figure as on 31.03.2008, which however cannot be more than Rs.1,00,00,000/-, without citing any basis for suggesting the valuation of Rs.1,00,00,000/-.

2.11. In respect of disallowance made under section 14A of the Act, it was submitted that total investments were in the sum of Rs. 58,34,000/- against which reserves and surplus stood at Rs.2,22,62,708/- demonstrating that own funds were much more than the investments and borrowed funds were not used for making the said

investments. Thus, it was contended that no disallowance is called for under section 14A read with rule 8D.

2.12. While arriving at the findings, Ld. CIT(A) noted that since Ld. AR stated that the price fetched by the property was lower compared to stamp duty value due to dispute in the property and also due to lower property prices in that area compared to market price, the AO was directed to refer the property for valuation to the DVO. Ld. CIT(A) also noted that the report of DVO was not received despite reminders and substantial passage of time. Leaving the issue midway at this stage, ld. CIT(A) examined the subject matter in terms of application of section 50C of the Act and gave his findings in favour of the assessee by holding that the transaction in question is an adventure in the nature of trade and thus assessable under the head business income. Accordingly, addition of long-term capital gain under section 50C of the Act of Rs.5,33,31,450/- made by the ld. AO was deleted.

2.13. On the alternative calculation of capital gains by the ld. AO as per section 45(2), ld. CIT(A) held that although no addition is made to total income, AO's alternative calculation of short-term capital gain under section 45(2) is found to be incomplete and without proper adoption of market value as on the date of conversion and without computation of business income/loss component and thus it is wrong and not permissible as per law.

2.14. Ld. CIT(A) also deleted the disallowance made under section 14A of the Act.

Aggrieved, the Department is in appeal before the Tribunal.

3. Before us, Ld. CIT DR submitted that Ld. AO has rightly treated the income arising from sale of impugned property as capital gains by applying the provisions of section 50C of the Act, on the following premises: –

(i) There was no clause in MoA and AoA of dealing in land and building, promoting of building construction;

(ii) Assessee has not dealt with any other land and building except the land in question, since its inception;

(iii) Act of conversion into stock in trade is contrary to the objectives and by-laws approved by RoC on the date of incorporation and status quo has been maintained due to want of official approval of RoC till date.

(iv) As submitted by the assessee itself, it had discontinued its business and had no staff and that it is the only property which it held as stock in trade.

3.1. On a specific query from the bench to the Ld. CIT DR as to whether there is any provision in the Act which requires the assessee to intimate the Department about conversion of capital asset into stock in trade, in the year of conversion itself, nothing specific was pointed to this effect. However, Ld. Counsel referred to clause 12A of Form 3CD (tax audit report) for AY 2008-09 placed at page 28 of supplementary paper book, wherein particulars of capital assets converted into stock in trade is required to be furnished and assessee has furnished the relevant details in respect of impugned transaction of sale of property under consideration.

4. Per contra, Ld. Counsel for the assessee reiterated the submissions made before the authorities below which are not reproduced for the sake of brevity as they have already been dealt in detail in the above paragraphs. However, Ld. Counsel referred to notes on financial statement for the year under consideration to show that inventory of the two divisions of the assessee has been reported separately in the balance-sheet placed at page 84 of the paper book. He pointed out that there are inventories for pharmaceutical division and for real estate division, reported separately.

4.1. On the alternative calculation for computing income from sale of land under section 45(2) adopted by the Ld. AO in paragraph 4 of the assessment order, Ld. Counsel submitted that Ld. AO took a faulty approach for arriving at fair market value of the property on the date of conversion that is on 31.03.2008 by resorting to back calculation by applying cost inflation index formula on the stamp duty value available of 22.01.2011. According to him, income has to be calculated into two components, one being capital gain on conversion of capital assets into stock in trade which is chargeable to tax in the year in which the converted stock in trade is sold by the assessee and second being the business income earned on the sale of stock in trade by the assessee. He thus stated that Capital gain has to be calculated by taking market value of the impugned property on the date of conversion from which the cost of acquisition is reduced. For calculating the business profits which is the second component, the fair market value of the stock in trade on the date of conversion is to be reduced from the sale consideration. Ld. Counsel submitted that though Ld. AO approached for the alternative calculation but left it by stating that assessee may not be taxed twice in different ways for the similar income and completed the assessment by making addition by applying the provisions of section 50C of the Act.

4.2. In respect of disallowance made under section 14A of the Act, Ld. Counsel placed reliance on the decision of Hon'ble Supreme Court in the case of *South Indian Bank v. CIT (2021) 322 CTR 465 (SC)* wherein it was held that if investments in tax-free securities is made out of common funds and assessee has available non-interest bearing funds larger than the investments made in tax-free securities, in such cases disallowance of interest under section 14A cannot be made.

5. We have heard the rival contentions and perused the material on record. We have also gone through the provisions of section 50C and

section 45(2) read with section 2(14) of the Act. We note that Ld. AO has calculated the income on the sale transaction of impugned land property by resorting to both the provisions under the Act, i.e. under section 50C and section 45(2) of the Act. Ld. AO has disregarded the conversion of capital asset into stock in trade by the assessee in the financial year 2007-08 relevant to AY 2008-09 merely for want of fair market value of the impugned property on the date of conversion for which he adopted the back calculation by applying cost inflation index on the stamp duty value of 22.01.2011. In this respect, we note that Ld. CIT(A) also left the alternative calculation taken up by the Ld. AO under section 45(2) midway, merely because of the reason that report of the DVO was not received despite reminders and substantial passage of time. Further, as noted above, assessee itself submitted that Ld. AO should have referred the matter for determination of fair market value as on 31.03.2008 to the DVO which was not done.

5.1. Before proceeding further, let us apprise ourselves with the provision of section 45(2) which is reproduced hereunder for ready reference:-

“Sec. 45(2) Notwithstanding anything contained in sub-section (1), the profits or gains arising from the transfer by way of conversion by the owner of a capital asset into, or its treatment by him as stock-in-trade of a business carried on by him shall be chargeable to income-tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him and, for the purposes of section 48, the fair market value of the asst on the date of such conversion or treatment shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.”

5.2. From the perusal of above section we note that income of assessee in the year of sale of converted stock in trade is divided into two parts, viz.,

(i) capital gain on the event of conversion of capital asset into stock in trade which is arrived at by deducting cost of acquisition of the capital asset from the fair market value of the capital asset on the date of conversion, and

(ii) business income on the event of sale of stock in trade which is arrived at by deducting the cost of the said stock in trade as recorded in the books of the assessee (which is the fair market value on the date of conversion) from the sale consideration.

5.3. We also understand that it is the prerogative of the assessee to convert its capital asset into stock in trade for which it is obliged to demonstrate its intention of doing so under the provisions of the Act. As noted above, the capital arising from such conversion is chargeable to income-tax not in the year of alleged conversion but only in the year in which the converted stock in trade is sold. In the year of conversion, the exercise of conversion *per se* does not have any implication on the taxability of the assessee. It is the assessment year in which the said converted stock in trade is sold wherein the ld. AO gets an occasion to examine the veracity of the claim of the assessee on the conversion and its relevant income reported by it in the return. Thus, in the year in which the alleged converted stock in trade is sold, the ld. AO has all the powers to examine veracity of claim of conversion as well as the computation of income in respect of the alleged conversion to ascertain the fair market value of the property on the date of said conversion.

5.4. In the present case before us, we note that both, ld. AO and ld. CIT(A) left the calculation of income on the sale transaction of impugned land property midway, owing to non-availability of fair market value of impugned land property on the date of conversion i.e. as on 31.03.2008. We note that Ld. CIT(A) while giving relief to the assessee has accepted the income from the sale transaction of the impugned land as business income as claimed by the assessee in its return. By accepting such a claim of the assessee by the Ld. CIT(A), it implies that provisions of section 45(2) have been applied which is without verifying and examining the veracity of the claim of conversion itself. It is pertinent to note that assessee itself made a submission before the ld. AO vide its letter dated 09.03.2016, contents of which are reproduced in para 2.2

above, whereby assessee had discontinued its business and had no staff and also that the impugned property is the only property which it held as stock in trade.

5.5. We have already noted that there are two components of income which are brought to tax when the provisions of section 45(2) are applied, viz., capital gains on the conversion and business income on the sale of converted stock in trade. In the present case, the business income is subjected to tax as claimed by the assessee and allowed by the Ld. CIT(A). However, the other component of capital gains on the conversion of capital asset into stock in trade has been assumed to be forming part of the business income itself, which to our mind is not a correct application of the provisions of section 45(2) of the Act. In this respect, Ld. CIT(A) notes as under: –

“Thus the total income remains the same. Only is divided into two parts, capital gain on conversion and business on sale. In case of LTCG on conversion the assessee gets benefit, otherwise not because the rate of tax for STCG and business income is the same. In the instant case the assessee as considered the whole income under the head business since the property was converted into stock in trade at cost. Therefore, in view of the accounts of the appellant company and facts on record and the provisions of section 45(2) and CBDT circular and since STCG is involved, I find the submissions / arguments of the assessee as a reasonable as per facts and in law and accordingly I hold that no additional income is assessable on the sale of the property at Cossipore by the appellant during the year.”

5.6. In the course of Hearing before us, Ld. Counsel for the assessee placed reliance on the decision of coordinate bench of *ITAT Kolkata* in the case of the *DCIT v. Poddar Projects Ltd* in *ITA No. 2752 & 2753/Kol/2013 dated 18.05.2018*. From the perusal of this order, we note that in para 6, it is categorically mentioned that at the time of conversion, assessee had obtained a report from registered valuer in respect of the capital asset which was converted into stock in trade and the said valuation report was placed on record.

5.7. Ld. Counsel also placed reliance on the decision of coordinate bench of *ITAT Mumbai* in the case of *Tata Housing Development Co. Ltd.*

v. Dept. of Income-tax in ITA No. 6793 & 6326/M/03 dated 31.07.2003.

In this decision also from para 32, we note that fair market value of the capital asset converted into stock in trade was available at the time of conversion and the difference between the fair market value and cost was recorded in the books of account as gain arising from such transfer. We also note that the issue involved in this case was in respect of correctness of examining the genuineness of transaction of conversion by the Revenue in the year in which the asset is sold as against in the year in which the conversion took place. Thus, the decisions relied upon by the Ld. Counsel are distinguishable on facts.

5.8. We find that in the present set of facts, it is proper to set aside the order of ld. CIT(A) on the issue of income from sale transaction of land property and remit the matter back to the file of Ld. CIT(A) to call for and obtain the pending valuation report from the DVO for which he had directed the Ld. AO as stated in part 3.2 of his order. We also direct to conduct due verification and examination of the claim of conversion made by the assessee in terms of our above observations for which, if deem fit, a remand report may be called from the ld. AO. Based on the valuation report of the DVO, examination of the veracity of claim of conversion and the remand report from the ld. AO, if any, Ld. CIT(A) is directed to arrive at both the components of income from sale transaction of the impugned land property by applying the provisions of section 45(2) of the Act and decide the issue accordingly. The assessee is also directed to cooperate with the Ld. DVO and Ld. CIT(A) in having the valuation done to arrive at the fair market value of the impugned land property as on 31.03.2008 i.e. the date of conversion. Needless to say that the assessee be given a reasonable opportunity of the heard before disposal of the appeal by the Ld. CIT(A). In the result, ground taken by the Department in this respect is partly allowed for statistical purposes.

6. In respect of disallowance made under section 14A of the Act, the undisputed facts are that own funds available with the assessee are much more than the investments made by the assessee. Accordingly, respectfully following the decisions referred by the Ld. Counsel in the case of *South Indian Bank (supra)* by the Hon'ble Supreme Court, we direct to delete the disallowance made by the ld. AO under section 14A of the Act. Thus, ground taken by the Department in this respect is dismissed.

7. In the result, appeal of the Department is partly allowed for statistical purposes.

Order is pronounced in the open court on 12th October, 2022

Sd/-

**(SANJAY GARG)
JUDICIAL MEMBER**

JD, Sr. P.S.

Sd/-

**(GIRISH AGRAWAL)
ACCOUNTANT MEMBER**

Dated: 12.10.2022

Copy to:

1. The Appellant:
2. The Respondent:.
3. The CIT(A)-4, Kolkata.
4. The CIT .Kolkata
5. The DR, ITAT, Kolkata Bench, Kolkata

//True Copy//

By Order

Assistant Registrar
ITAT, Kolkata Benches, Kolkata