

आयकर अपीलीय अधिकरण, राजकोट न्यायपीठ, राजकोट
**IN THE INCOME TAX APPELLATE TRIBUNAL
RAJKOT BENCH, RAJKOT**

(Conducted Through Virtual Court)

**BEFORE SMT.ANNAPURNA GUPTA, ACCOUNTANT MEMBER
AND
MS.SUCHITRA RAGHUNATH KAMBLE, JUDICIAL MEMBER**

**ITA No.64/RJT/2015
Assessment Year : 2010-11**

M/s.Flamingo Hotels P.Ltd. Plot No.416 Ward-2B Adipur-Kutch.		ITO, Ward-1 Gandhidham.
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(Applicant)		(Responent)
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Assesseeby :	Shri Vimal Desai, ld.AR
Revenue by :	Shri Shramdeep Sinha, ld.CIT-DR

सुनवाई की तारीख/Date of Hearing : 19/10/2023

घोषणा की तारीख /Date of Pronouncement: 10/11/2023

आदेश/ORDER

PERANNAPURNA GUPTA, ACCOUNTANT MEMBER

Present appeal has been filed by the assessee against order passed by the ld.Commissioner of Income-Tax(Appeals)-3, Rajkot [hereinafter referred to as "ld.CIT(A)"] dated 20.1.2015 passed under section 250(6) of the Income Tax Act, 1961 [hereinafter referred to as "the Act" for short]for the Asst.Year 2010-11.

2. The only ground raised by the assessee in the appeal reads as under:

“2. The ld.AO has erred in law as well as on facts in determining the total income at Rs.4,14,78,398/- by rejecting the claim of the appellant with regards to capita loss on account of destruction of superstructure. The ld.CIT(A) has erred in confirming the same.”

3. As noted above, the solitary issue in the present appeal pertains to the rejection of the claim of the assessee of capital loss relating to destroyed superstructure/ building, which loss was claimed by the assessee on transfer of land on which superstructure was constructed. The quantum of loss denied amounted to Rs.8,86,15,790/-.

4. The facts pertaining to the issue being that during the impugned year, the assessee had sold land for a consideration of Rs.5 crores, the impugned year being Asst.Year 2010-11. The said land was purchased on 27.6.1996 for Rs.38,76,924/- and its indexed cost in the impugned year was Rs.80,33,495/-. On the said land the assessee had constructed a building for running a hotel, and had incurred cost of Rs.8,86,15,798/-. In the year 2001, this building was destroyed by earthquake. While computing the capital gains on transfer of land during the impugned year, the assessee claimed this cost of building destroyed of Rs.8.86 crores as cost of improvement of land, and accordingly computed capital loss on transfer of property at Rs.4,67,41,784/-.

During assessment proceedings, the AO examined the issue and held that the land & building are separate property, and therefore, the cost of building could not be treated as cost of improvement. He held that while the land was transferred in the impugned year, and capital gain earned thereon had to be computed separately, the building, he held, stood transferred in the year in

which it was destroyed i.e. in the year 2001 when the right in the building stood extinguished, which tantamounted to “transfer” in terms of definition of the term under section 2(47) of the Act. For this interpretation, that on the destruction of the building the right in the building stood extinguished which tantamounted to transfer of building, he relied on the decision of the Hon’ble Apex Court in the case of CIT Vs. Grace Collis &Ors., 248 ITR 323. Accordingly, as per the AO, the assessee was not entitled to any claim of loss on account of destruction of the building in the impugned year.

5. The AO also looked into this aspect from the perspective of section 45(1A) of the Act, which deems transfer of asset destroyed or annihilated on receipt of insurance claim. Interpreting the said section, the AO stated that as per section 45(1A) it is only on receipt of insurance claim that transfer of the destroyed asset is to be deemed and gains computed and in the facts of the present case, he noted that since the assessee’s claim was rejected by the insurer and matter was pending before the Hon’ble High Court, there was no case of any capital loss being returned in terms of section 45(1A) of the Act in the impugned year.

Accordingly, the loss claimed by the assessee on account of destroyed superstructure was denied by the AO.

6. The matter was carried in appeal before the ld.CIT(A) who rejected the AO’s finding that there was transfer of building in the year of destruction of the asset i.e. in Asst.Year 2001-02 on extinguishment of right in the building. He noted that reliance placed by the AO on the decision of Hon’ble Apex Court in the case of CIT Vs. Grace Collis &Ors. (supra) was misplaced since in a subsequent decision, the Hon’ble Madras High Court in the case of

Neelamalai Agro Industries Ltd. Vs. CIT, 259 ITR 651, had categorically stated that decision of the Hon'ble Apex Court in the case of CIT Vs. Grace Collis (supra) was rendered in different set of facts and had not dealt on the issue of extinguishment of rights in assets particularly on destruction. Hon'ble Madras High Court held that therefore the decision of Hon'ble Supreme Court in Vania Silk Mills Vs. CIT, 1991] 191 ITR 647, which specifically dealt with the aspect of extinguishment of right in a destroyed asset holding that there was no transfer on destruction of asset, would still hold good.

The Id.CIT(A) accordingly held that there was no transfer of building in year of destruction i.e. in 2001.

However, on the aspect of transfer taking place in terms of section 45(1A) of the Act, he agreed with the AO that in terms of the said section transfer would take place in the year of receipt of insurance claim by the assessee, and since the matter was pending before Hon'ble Court, section 45(1A) of the Act would be applicable only when the assessee's appeal is finally decided by the Hon'ble Court. Accordingly, the Id.CIT(A) also rejected the assessee's claim of loss on the destroyed asset in the impugned year.

7. Aggrieved by this order of the Id.CIT(A), the assessee is in further appeal before the Tribunal.

8. We have heard both the parties. The assessee's plea before us is that the loss on the building destroyed of Rs.8.86 Crs is allowable in the impugned year i.e. A.Y 10-11. The Ld.CIT(A) has rejected this plea of the assessee as also the order of the AO holding that the loss is allowable in the year in which the asset was destroyed by earthquake, i.e. 2001. The Ld.CIT(A) has applied section 45(1A) of the

Act to the issue and held that the loss is allowable in the year the insurance claim is settled by the Hon'ble High Court where the assessee has appealed against the rejection of claim by insurance company. It was stated at bar before us that the matter is till as on date pending before the Hon'ble High Court.

We are in agreement with the Ld.CIT(A) that the computation of capital gains in the present case is governed by section 45(1A) of the Act ,but at the same time we do not agree with the interpretation of the said section by the Ld.CIT(A) to the effect that the transfer of the destroyed asset will be deemed in the year the assesses claim is finally settled in appeal by the Hon'ble High Court.

Before proceeding, it is pertinent to clarify the import and scope of section 45(1A) of the Act. The said section is reproduced hereunder for clarity:

45. (1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 54, 54B, 54D, 54E, 54EA, 54EB, 54F, 54G and 54H, be chargeable to income-tax under the head "Capital gains", and shall be deemed to be the income of the previous year in which the transfer took place.

(1A) Notwithstanding anything contained in sub-section (1), where any person receives at any time during any previous year any money or other assets under an insurance from an insurer on account of damage to, or destruction of, any capital asset, as a result of—

- (i) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or*
- (ii) riot or civil disturbance; or*
- (iii) accidental fire or explosion; or*
- (iv) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war),*

then, any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head "Capital gains" and shall be deemed to be the income of such person of the previous year in which such money or other asset was received and for the purposes of section 48, value of any money or the fair market value of other assets on the date of such receipt shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital asset.

9. This section specifically deals with capital gains on assets destroyed on which insurance claims are received, deeming the capital gains in such circumstances attributable to the year in which claim is received.

This section was inserted in the Act by way of Finance Act,1999.The CBDT Circular No.779 dated 14thSeptember 1999, being Explanatory Notes on the provisions in the Finance Act,1999 relating to direct taxes explained the background leading to the insertion of the provision and the scope of the same as under:

“Taxing profits and gains arising from insurance claim received for damage or destruction of a capital asset as capital gains:

Variuos courts have held that there is no transfer when the asset is destroyed as the asset has to exit in the process of transfer. Themoney received under insurance policy is compensation by virtue of contract of insurance and not consideration for transfer. It is proposed to provide that the profits and gains arising from the receipts of an insurance claim on account of destruction or damage of a capital asset as a result of fire, flood, earthquake, civil disturbance and war, etc. shall be deemed to be capital gains for the purposes of section 48 and taxed in the year of receipt.

The proposed amendment will take effect from 1st day of April 2000 and will accordingly apply to assessment year 2000-2001 and subsequent years.”

10. As is evident from the above, section 45(1A) of the Act deems “transfer” of a capital asset which is otherwise damaged,destroyed or annihilated, on happening of the event of receipt of insurance claim. On happening of such event, the destroyed asset is deemed to be transferred and capital gain or loss earned thereon is liable totax in that year. This provision was introduced vide Finance Act 1999 and

was brought on the statute to overcome the decision of the Hon'ble Apex Court in the case of Vania Silk Mills (supra), wherein the Hon'ble Apex Court had categorically held that on the destruction of an asset there is no transfer of asset in terms of section 2(47) of the Act. The Hon'ble Apex Court held that extinguishment of right in an asset, which qualified as transfer in terms of section 2(47) of the Act, has to be accompanied with the transfer taking place of the asset to some other person; that in the absence of this event happening in the case of destruction of an asset, though there is extinguishment of asset, but it does not qualify as extinguishment of right in asset *on transfer* as required under section 2(47) of the Act. Hon'ble Apex Court held that the amount received from insurance company on account of claim made by the assessee for destroyed assets is only by way of compensation for loss and by any stretch of logic cannot be treated as a consideration for transfer of an asset. To overcome this decision of Hon'ble Apex Court, provision of section 45(1A) was brought in the Statute by Finance Act 1999 to provide for deemed transfer of asset taking place on receipt of insurance claim, the asset being in the nature of destroyed or annihilated state; that therefore on the deemed transfer taking place, capital gain or loss was to be computed and return to tax accordingly.

In the facts of the present case the asset/ building undoubtedly has been destroyed in an earthquake and the assessee has claimed compensation from the insurance company on the same, the receipt of which is subject matter of appeal before the Hon'ble High Court. Therefore, capital gains is to be determined in accordance with section 45(1A) of the Act.

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Now coming to the aspect of the year in which the capital gain/loss is to be deemed to relate to as per the section we hold that it pertains to the year in which the claim of the assessee was initially rejected by the insurance company. Our reasoning for the same is as under.

The AO in his order has reproduced the Memorandum explaining the provisions of section 45(1A) of the Act as inserted by the Finance Act, 1999, pointing out there from that it clearly states that it is a beneficial section to the assessee to claim loss from earthquake which was otherwise not possible. The relevant portion of the order of the AO at para 6.17 is reproduced hereunder:

“..... It is also important in this regard to quote the provisions of Memorandum explaining the provisions of section 45(1A), which clearly says that it is beneficial section for assessee to claim the loss from earthquake, which was otherwise not allowable as claimable in any year. The said part of Memorandum explaining the provisions of section 45(1A) as inserted by Finance Act, 1999 is as under:

“Taxing profits and gains arising from insurance claim received for damage or destruction of a capital asset as capital gains

Various courts have held that there is no transfer when the asset is destroyed as the asset has to exist in the process of transfer. The money received under insurance policy is compensation by virtue of contract of insurance and not consideration for transfer. It is proposed to provide that the profits and gains arising from the receipts of an insurance claim on account of destruction or damage of a capital asset as a result of fire, flood, earthquake, civil disturbance and war etc. shall be deemed to be capital gains for the purposes of section 48 and taxed in the year of receipt.

The proposed amendment will take effect from 1st day of April 2000 and will accordingly apply to assessment year 2000-2001 and subsequent years.”

11. It is clearly evident that the Department is agreeable with the interpretation of section 45(1A) of the Act to mean that on the happening of an event of settlement of insurance claim and receipt of money from the insurance company, the destroyed asset is to be deemed to be transferred and capital loss or capital gain to be computed thereon in terms of provision of section 48 of the Act, taking into consideration cost of asset to be set off against the insurance claim receipt.

12. Having said so, we find that in the facts of the present case, the assessee's insurance claim was rejected and he received no amount on account of the said claim. The Id.CIT(A) in his order has stated that the rejection of the assessee's claim is to be treated as Zero amount received from the insurance company, and provision of section 45(1A) of the Act to be invoked accordingly. The Id.CIT(A) at page no.14 of his order has stated, if the assessee's appeal is rejected by the Hon'ble Court, the insurance received by the assessee can be treated as Zero and then capital loss calculated. His finding in this regard at page 14 of his order are reproduced hereunder:

"... Even if assuming the decision of the High Court to be against the appellant, the insurance received by the appellant can be treated as zero and then the capital loss calculated."

13. Therefore, accepted position of the Revenue is that section 45(1A) of the Act is invoked on the settlement of the insurance claim of the assessee, and even if the claim is rejected, it is to be treated as Zero receipt of insurance claim, and capital gain or loss to be computed accordingly. The AO's reference to the Memorandum explaining the provision of section 45(1A) of the Act fortify our view

mentioning that section 45(1A) is beneficial for the assessee to claim the loss on destroyed assets on the settlement of their insurance claim.

14. Having said so, in the facts of the present case, the insurance claim of the assessee was rejected, however, the assessee has filed an appeal to the Hon'ble High Court, which is still pending. As per the AO and the Id.CIT(A), only on the settlement of the appeal by the Hon'ble High Court, section 45(1A) of the Act will come into play. On this aspect, we are not in agreement with the Revenue authorities. In our view, the provisions of section 45(1A) are invoked in the first instance when the claim of the assessee was rejected by the insurance company. The settlement of the dispute of the assessee with the insurance company in appeal would relate back and be effective for the year in which the claim was initially settled by the insurance company.

Therefore, we hold that for all purposes, the year in which assessee's claim for insurance is rejected will invoke provision of section 45(1A) of the Act in the said year. Receipt of insurance claim, as per the Id.CIT(A), is to be treated as zero and the assessee accordingly is entitled to compute his capital loss and claim the same in the said year. We hold, therefore, that the capital loss of the assessee on the destroyed building is to be computed in terms of section 45(1A) of the Act, and as per the facts and circumstances of the case, it pertains to the Asst. Year when its insurance claim was rejected by the Insurance Company. The assessee is, therefore, entitled to claim capital loss on account of destroyed building in the said Asst. Year.

15. The AO is directed to treat the capital loss on account of destroyed building as pertaining to the Asst.Year in which his claim for insurance was rejected by the Insurance Company and allow set off of the same against the capital gain on sale of land, if within the period specified in the Statute.

16. In the result, the appeal of the assessee is dismissed with the above directions.

Order pronounced in the Court on 10th November, 2023 at Ahmedabad.

**Sd/-
(SUCHITRA R. KAMBLE)
JUDICIAL MEMBER**

**Sd/-
(ANNAPURNA GUPTA)
ACCOUNTANT MEMBER**

Ahmedabad,dated 10/11/2023