

**IN THE INCOME TAX APPELLATE TRIBUNAL  
“B” BENCH: BANGALORE**

**BEFORE SHRI WASEEM AHMED, ACCOUNTANT MEMBER  
AND  
SHRI SOUNDARARAJAN K., JUDICIAL MEMBER**

ITA No.692/Bang/2024
Assessment Year: 2017-18

M/s. Atria Wind (Kadambur) Private Limited No.11, 1 <sup>st</sup> Floor Commissariat Road Ashok Nagar Bengaluru 560 025  <b>PAN NO : AAPCA4799J</b>	<b>Vs.</b>	DCIT Central Circle-2(4) Bangalore
<b>APPELLANT</b>		<b>RESPONDENT</b>

<b>Appellant by</b>	:	Sri V. Srinivasan, A.R.
<b>Respondent by</b>	:	Sri Vilas V. Shinde, D.R.

<b>Date of Hearing</b>	:	18.07.2024
<b>Date of Pronouncement</b>	:	15.10.2024

**O R D E R**

**PER SOUNDARARAJAN K., JUDICIAL MEMBER:**

This is an appeal filed by the assessee challenging the order of CIT(A)-15, Bangalore dated 30.3.2024 in respect of the assessment year 2017-18.

**2.** Brief facts of the case are that a search was carried on u/s 132 of the Income Tax Act, 1961 (in short “The Act”) and during the said search, some records were found and seized by the department. Thereafter, notice u/s 153A of the Act was issued for which the assessee filed its return of income on 29.11.2021 declaring a loss of Rs.2,83,86,495/- which was already reported in the original return. Thereafter, notices u/s 143(2) & 142(1) of the Act were issued along with detailed questionnaire. The assessee filed their explanations and also produced the documents called for by the AO. The AO by

his order dated 30.03.2022 had determined the total income of the assessee at Rs.189,11,81,757/- as against the loss reported by the assessee by making the addition of capital gains on the conversion of partnership firm M/s. Perpetual Investments into the assessee company. The assessee challenged the above said order of assessment before the Id. CIT(A) on the ground that there was no seizure of any incriminating materials at the time of search and the assessment made u/s 143(3) of the Act is bad in law since no notice u/s 143(2) of the Act was issued by the AO. The assessee also contended that the addition made under the head "Long Term Capital Gain" on conversion of the partnership firm into a company is also not in accordance with section 47(xiii) of the Act. The Id. CIT(A) had dismissed the appeal and confirmed the addition made under the head capital gains and in respect of the ground No.6, which relates to the levy of interest u/s 234B & 234C of the Act, the Id. CIT(A) had remitted the issue to the file of AO for recomputing the interest while giving effect to the order. The assessee aggrieved with the order of the Id. CIT(A) had filed the present appeal before this Tribunal with the following grounds :

1. *The orders of the authorities below in so far as they are against the appellant are opposed to law, equity, weight of evidence, probabilities, facts and circumstances of the case.*
2. *The order passed u/s. 153A rws 143[3] of the Act, on the appellant is bad in law in as much as the conditions specified u/s. 132A[1][a], [b] and [c] did not exist to issue the warrant of search and consequently, the search action taken against the appellant is illegal and the assessment founded on the said search operation is also illegal and is also bad in law and consequent assessment requires to be annulled.*
3. *Without prejudice to the above, the appellant denies itself liable to the assessed on a total income of Rs. 189,11,81,757/- as determined in the impugned order passed as against the returned loss of Rs. 2,83,86,495/- by making an addition of Rs.191 ,95,68,251/- as long term capital gains under the facts and in the circumstances of the appellant's case.*

4. *The learned CIT [A] is not justified in upholding the addition of Rs.191,95,68,251/- under the head Long Term Capital gains holding that the conversion of the partnership firm M/S. Perpetual Investments into a private limited company amounts to transfer under the facts and in the circumstances of the appellant's case.*
5. *The learned CIT [A]. ought to have appreciated that the various materials pointed out in the impugned order cannot be regarded as incriminating materials by any stretch of imagination since they are normal documents maintained in ordinary course of business besides being legal opinion sought and received and therefore, no addition could be made on the basis of these documents in the assessment u/s. 153A of the Act, which had not abated as a result of the search and hence, the impugned addition made deserves to be deleted under the facts and in the circumstances of the appellant's case.*
  - 5.1 *The addition of Rs. 191 ,95,68,251/- made in the order passed u/s. 153A of the Act is beyond the scope of the present proceedings since the assessment is not an abated assessment especially considering the absence of incriminating material relating to the conversion of the erstwhile firm into the appellant company found during the course of search for the year under appeal and hence, the same deserves to be deleted.*
  - 5.2 *The learned CIT[A] further ought to have appreciated that there was no scheme or arrangement devised by the appellant to disentitle the exemption on capital gains arising from conversion of the partnership firm into a private limited company, which finding recorded is purely on assumptions and presumptions and hence, the impugned addition made deserves to be deleted under the facts and in the circumstances of the appellant's case.*
6. *Without further prejudice, the learned CIT [A] erred in holding that the conditions as laid down in Section 47[xiii] of the Act had been violated under the facts and in the circumstances of the appellant's case.*
7. *Without further prejudice, the learned CIT [A] ought to have appreciated that the NAV method for computation of capital gains was unwarranted under the facts and in the circumstances of the appellant's case.*
8. *Without prejudice to the right to seek waiver with the Hon'ble CCIT/DG, the appellant denies itself liable to be charged to interest u/s. 234B and 234C of the Act, which under the facts and in the circumstances of the appellant's case deserves to be cancelled.*

9. *For the above and other grounds that may be urged at the time of hearing of the appeal, your appellant humbly prays that the appeal may be allowed and Justice rendered and the appellant may be awarded costs in prosecuting the appeal and also order for the refund of the institution fees as part of the costs.*

**3.** At the time of hearing, the ld. A.R. submitted that the order of AO as well as the ld. CIT(A) in confirming the addition made under long term capital gains is not correct and invited our attention to the various provisions of the Act and also the reply filed to the questionnaire issued by the AO and also the documents seized at the time of search and contended that there was no incriminating material seized by the department at the time of survey and hence, the proceedings initiated u/s 153A of the Act is not correct. The ld AR also contended that the conversion of partnership firm into a company is not liable to be taxed under the provisions of capital gains since the assessee had not violated any of the provisos enumerated u/s 47(xiii) of the Act. The ld. A.R. also filed a paper book containing pages 1 to 369 and enclosed the notices issued by the AO and the judgements of the Hon'ble Karnataka High Court and other records in support of his arguments that the assessee had not violated any of the provisos enumerated u/s 47(xiii) of the Act. The ld. A.R. also further argued that the word used in the proviso is "immediately before the succession" and therefore, the same should be interpreted to give the meaning that any violation should be immediately before the date of conversion and not something done much prior to the date of conversion. The ld. A.R. also submitted that no violation has been committed by the assessee immediately before the succession and therefore, the AO is not correct in making the addition under the head long-term capital gains. The ld. A.R. also relied on the judgement of the Hon'ble Bombay High Court as well as the Hon'ble Madras High Court in support of his arguments.

**4.** The ld. D.R. relied on the orders of the lower authorities and prayed to dismiss the appeal filed by the assessee.

5. We have heard both sides and perused the materials available on record. Before going into the issue in detail, we will consider the provisions which are relevant to the issue involved in this appeal and for the sake of clarity, we reproduce the sections.

**“Section 2(14) "capital asset" means—**

*(a) property of any kind held by an assessee, whether or not connected with his business or profession;*

*(b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992 (15 of 1992);’*

*[(c) any unit linked insurance policy to which exemption under clause (10D) of section 10 does not apply on account of the applicability of the fourth and fifth provisos thereof,]*

*but does not include—*

*(i) any stock-in-trade [other than the securities referred to in sub-clause (b)], consumable stores or raw materials held for the purposes of his business or profession ;*

*(ii) personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him, but excludes—*

*(a) jewellery;*

*(b) archaeological collections;*

*(c) drawings;*

*(d) paintings;*

*(e) sculptures; or*

*(f) any work of art.*

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**“Section 2(47) of the Act:**

*"transfer", in relation to a capital asset, includes,—*

*(i) the sale, exchange or relinquishment of the asset ; or*

*(ii) the extinguishment of any rights therein ; or*

*(iii) the compulsory acquisition thereof under any law ; or*

*(iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment.*

*.....”*

**“Section 45 Capital gains.**

*(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.*

*Explanation.—For the purposes of this sub-section, the expression "insurer" shall have the meaning assigned to it in clause (9) of section 2 of the Insurance Act, 1938 (4 of 1938).*

*[(1B) Notwithstanding anything contained in sub-section (1), where any person receives at any time during any previous year any amount under a unit linked insurance policy, to which exemption under clause (10D) of section 10 does not apply on account of the applicability of the fourth and fifth provisos thereof, including the amount allocated by way of bonus on such policy, then, any profits or gains arising from receipt of such amount by such person 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 amount was received and the income taxable shall be calculated in such manner as may be prescribed.]*

*(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 asset 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.*

*(2A) Where any person has had at any time during previous year any beneficial interest in any securities, then, any profits or gains arising from transfer made by the depository or participant of such beneficial interest in respect of securities shall be chargeable to income-tax as the income of the beneficial owner of the previous year in which such transfer took place and shall not be regarded as income of the depository who is deemed to be the registered owner of securities by virtue of sub-section (1) of section 10 of the Depositories Act, 1996, and for the purposes of—*

*(i) section 48; and*

*(ii) proviso to clause (42A) of section 2, the cost of acquisition and the period of holding of any securities shall be determined on the basis of the first-in-first-out method.*

*Explanation.—For the purposes of this sub-section, the expressions "beneficial owner", "depository" and "security" shall have the meanings respectively assigned*

to them in clauses (a), (e) and (l) of sub-section (1) of section 2 of the Depositories Act, 1996.

*(3) The profits or gains arising from the transfer of a capital asset by a person to a firm or other association of persons or body of individuals (not being a company or a co-operative society) in which he is or becomes a partner or member, by way of capital contribution or otherwise, shall be chargeable to tax as his income of the previous year in which such transfer takes place and, for the purposes of section 48, the amount recorded in the books of account of the firm, association or body as the value of the capital asset shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.*

*[(4) Notwithstanding anything contained in sub-section (1), where a specified person receives during the previous year any money or capital asset or both from a specified entity in connection with the reconstitution of such specified entity, then any profits or gains arising from such receipt by the specified person shall be chargeable to income-tax as income of such specified entity under the head "Capital gains" and shall be deemed to be the income of such specified entity of the previous year in which such money or capital asset or both were received by the specified person, and notwithstanding anything to the contrary contained in this Act, such profits or gains shall be determined in accordance with the following formula, namely:—*

$$A = B + C - D$$

*Where,*

*A = income chargeable to income-tax under this subsection as income of the specified entity under the head "Capital gains";*

*B = value of any money received by the specified person from the specified entity on the date of such receipt;*

*C = the amount of fair market value of the capital asset received by the specified person from the specified entity on the date of such receipt; and*

*D = the amount of balance in the capital account (represented in any manner) of the specified person in the books of account of the specified entity at the time of its reconstitution:*

*Provided that if the value of "A" in the above formula is negative, its value shall be deemed to be zero :*

*Provided further that the balance in the capital account of the specified person in the books of account of the specified entity is to be calculated without taking into account the increase in the capital account of the specified person due to revaluation of any asset or due to self-generated goodwill or any other self-generated asset.*

### **“Section 47(xiii) of the Act”**

*[any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of [demutualisation or corporatisation of a recognised stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company]*

*:Provided that—*

*(a) all the assets and liabilities of the firm or of the association of persons or body of individuals relating to the business immediately before the succession become the assets and liabilities of the company;*

*(b) all the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of the succession;*

*(c) the partners of the firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company; and*

*(d) the aggregate of the shareholding in the company of the partners of the firm is not less than fifty per cent of the total voting power in the company and their shareholding continues to be as such for a period of five years from the date of the succession;*

*(e) the demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for demutualisation or corporatisation which is approved by the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);*

**5.1** As seen from the above provisions the capital asset has been defined u/s 2(14) of the Act and similarly Section 2(47) of the Act defines the transfer in relation to a capital asset. Section 45 of the Act deals with the profits or gains arising out of the transfer of the capital asset and treated the same as deemed income. Admittedly, in this case, there is a transfer of capital asset owned by the firm during the previous year while converting the partnership firm into a company.

**5.2** Even though the capital gains provision would apply, Section 47 of the Act grants exceptions to Sec 45 in which certain transactions are not treated as transfer and therefore not attracted the Capital Gains provision. We are concerned with sub clause (xiii) of Sec 47 of the Act in which the statute imposed some conditions by way of proviso to Section 47 (xiii) of the Act. In sub clause (xiii) of Sec 47, the statute had not recognized transfer of capital asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm as transfer of capital asset. In the above circumstances there is no transfer and consequently Sec 45 would not apply and therefore it would not be treated as income and attract capital gains. The statute laid down five conditions by way of proviso to the sub-clause (xiii) of section 47 for the entitlement of the benefit. The AO mainly relied on these provisos and alleged

that the assessee had violated the proviso (a) & (c) of section 47(xiii) of the Act and therefore, the transfer of the capital asset by a firm to assessee company by way of succession is liable to be taxed as income arising out of the transfer of the capital asset. In the assessment order dated 30.3.2022, the AO had mainly relied on the search conducted u/s 132 of the Act and the alleged seizer of incriminating materials and on that basis notice u/s 153A was issued as if the seized materials are incriminating materials. Thereafter assessment proceedings commenced and the AO raised the following queries and also extracted the details of the incriminating documents found at the time of search, which are as follows:

1. What are the tax implications, if any in the hands of the partners on withdrawals from their respective capital/ current account(s), including the profits on sale of investments?
2. Whether transfer of the business by the Firm to New Co and subsequent receipt of consideration by the partners in their individual capacity would be considered as a valid transfer of business under general law?
3. Would the business of the Firm (comprising of assets and liabilities) qualify as a 'capital asset' as contemplated under Section 47(xiii) of the Income Tax Act ("IT Act")?
4. Whether transfer of the business from the Firm to New Co, pursuant to a Business Succession Agreement would qualify as a 'succession' as contemplated under Section 47(xiii) of the IT Act?
5. Whether the term 'succession' as used in Section 47(xiii) of the IT Act would mean 'succession' as used in the context of Section 170 of the IT Act?
6. In the event, the answers to the above queries are negative (or the tax department adopts a position that the business transfer is not exempt under section 47(xiii)), what would be the tax implications in the hands of the partners, given that the consideration for the business transfer would be directly allotted to the partners of the Firm in their individual capacities.
7. Would the shares allotted to the partners of the Firm by New Co for the said transfer fall within the purview of Section 56(2)(vii) of the IT Act? In case, the answer is in the affirmative, then what would be the consideration for the shares received in the hands of the partners?
8. Whether any future funding in New Co (as envisaged in step 8 or 9) be undertaken otherwise than by issue of equity shares i.e., by way of redeemable preference shares, debentures, loan, and share warrants. In case the answer is in the affirmative, whether the same would satisfy conditions prescribed under Section 47(xiii) of the IT Act?
9. Would there be any stamp duty implications on transfer of the Firm to New Co, pursuant to the succession as contemplated under Section 47(xiii) of the IT Act?

**5.3** Similarly, the AO had also extracted the incriminating documents seized at the time of search which are as follows;

S.No	Seizure Annexure	Description
1.	A/XB1/PO/04 Pages 183-188	Board resolution of ABPPL and AWPL and NOCs from M/s perpetual investments for conversion of

		firm to company.
2.	A/ABPPL/BVSC/01 Page 7-22	Note prepared by King & Partridge on income tax implications over sale of ACT equity shares by Shri C.S.Sunder Raju and invest the sale proceeds in wind/solar power projects in individual capacity. Subsequently, after claiming the depreciation on wind/solar projects assets, the wind/solar project business will be transferred to a newly formed company.
3.	A/ABPPL/BVSC/01 Pages 23-28	Valuation report prepared by King & Partridge for fixed assets of M/s Perpetual Investments dated 28.02.2017

5.1.2 During the course of survey proceedings u/s 133A of the Income Tax Act, 1961 from office of Shri CA Rama Mohan Rao KNS who is the main auditor of accounts for Atria group of companies following incriminating materials were impounded

S. No	Annexures	Description
1.	1/RMR/133A/1 Page 1-40	Documents consist of Indenture of retirement cum release of partnership firm M/s Perpetual Investments dated 06.07.2015 and copies of forms of registry of firm and PAN card of M/s Perpetual Investments.
2.	1/RMR/133A/1 Page 41-98	Copies of Indenture of reconstitution of firm M/s Perpetual Investments dated 06.07.2015.
3.	1/RMR/133A/1 Page 99-148	Copy of Indenture of retirement cum release of partnership firm M/s Perpetual Investments dated 06.07.2015. 4 108-148 Financials including computation of income, Balance sheet and P&L, Auditor's report, Fixed asset valuation sheet, ITR acknowledgement of M/s Perpetual Investments for FY 2015-16.

**5.4** We have gone through the alleged incriminating documents seized at the time of search and we found that at no stretch of imagination, the above said documents could be treated as incriminating records because they are only the documents maintained by the assessee during the normal course of business like Board Resolution, note prepared by the Advocate and the valuation report prepared by the advocate and the indenture of retirement-cum-release of partnership firm dated 06.07.2015 and

financial statements for the assessment year 2015-16. From the above said documents we are not able to find any incriminating evidence for the suppression of income. We therefore, does not accept the reasoning of the AO that these are all incriminating records recovered at the time of search from the assessee. Further, there is no suppression or escaped income made out by the AO, based on the seizure of the above said incriminating documents and therefore we are of the view that no assessment proceedings could be initiated u/s 153A of the Act when the assessment was completed. To arrive such a conclusion we relied on the judgement of the Hon'ble Supreme Court reported in 454 ITR page212 in the case of Abhisar Buildwell P Ltd.

**5.5** Next, we will consider the issue on merits, whether the assessee had committed any violation of the provisos to Section 47 (xiii) of the Act as alleged by the AO. We will go through the reasons stated by the AO for levying long term capital gains tax on the transfer of the firm's capital asset to the assessee as a result of succession of the firm by the company in the business carried on by the firm, when the assessee had not violated any of the conditions mentioned in the provisos to section 47(xiii) of the Act. The AO initially issued a show cause notice, proposing to add the long-term capital gains for the reason that the assessee had violated section 47(xiii) proviso (a) & (c) of the Act. Subsequently the assessee filed their detailed objections and demonstrated before the AO that none of the provisos were violated by them while transferring the firm into a company and therefore, claimed that the addition made under the head long term capital gains is not warranted. For the purpose of clarity, we are reproducing the objections filed by the assessee which is as follows:

*1. As regards to the condition a), the Partnership Firm "Perpetual Investments" has transferred all its Power generation activities by converting Partnership Firm to Atria Wind (Kadambur) P L. M/S Perpetual Investments, diversified into the business of generation of power by the wind energy by establishing and commissioning wind power plant at Ottapidaram, Kayathar, Tuticorin District, Tamil Nadu. The summary of assets and liabilities as per the books "Perpetual Investments" relating to power projects as on 26/03/2017 before succession as verifiable from the audited financial statements of M/s.Perpetual Investments as on 26/03/2017. The copy of Audited Financials as on 26/03/2017 is enclosed vide **Enclosure 1**. All the assets and liabilities of the firm relating to the business immediately before the succession become the assets and liabilities of the company as verifiable from the assets and liabilities that have been recorded in the books of the company on conversion of Partnership Firm in to company as on 26.03.2017 enclosed vide **Enclosure-2**.*

*2 As regards to the condition b), the Partners of the firm immediately before the succession become the shareholders of the Company in the same proportion in which their capital accounts stood in the books of firm as under :*

<i>Particulars</i>	<i>Partnership Share %</i>	<i>No of Equity shares allotted</i>	<i>Percentage of Equity Share Capital</i>

Atria Brindavan Power Pvt Ltd	1%	10000	1%
C S Sunder Raju	1%	10000	1%
K Nagaraju	1%	10000	1%
Atria Wind Pvt Ltd	94%	940000	94%
Mrs. Bharathi N Raju	1%	10000	1%
Mrs. Thejavathi Raju	1%	10000	1%
Kaushik Raju	1%	10000	1%
Total	100%	1000000	100%

3. As regards to the condition c), the Partners have received the consideration pursuant to the business succession to the company in the form of allotment of following Shares only as explained above and has not received any other consideration other than by way of allotment of shares.

As to the condition d), the Shareholding of Partners, in the Company, Wind (Kadambur) Pvt Ltd in the form of Equity Shares having voting rights under:

As on 27/03/2017	As on 31/03/2018	As on 31/03/2019	As on 31/03/2020	As on 31/03/2021
9,40,000	9,40,000	9,40,000	9,40,000	9,40,000
10,000	10,000	10,000	10,000	10,000
10,000	10,000	10,000	10,000	10,000
10,000	10,000	10,000	10,000	10,000
10,000	10,000	10,000	10,000	10,000
10,000	10,000	10,000	10,000	10,000



<i>Kaushik</i>	10,000	10,000	10,000	10,000	10,000
<i>Raju</i>					
<i>Total No of</i>	10,00,00	10,00,000	10,00,000	10,00,000	10,00,000
<i>Equity</i>	0				
<i>Shares held</i>					

*Note: The Partners continue to hold more than 50% voting power in the company in the form of Equity Shares having voting rights and has been holding the same as on 31/03/2021 and should continue to hold till 27/03/2022.*

*In conclusion, we submit that, as explained above, the conditions laid down in paras a), b), c) and d) in Section 47(xiii) of the Income Tax Act, 1961 have been fully complied with by us, viz., the successor company, M/s. Atria Wind (Kadambur) Pvt Ltd and consequently, we submit that, the issue of taxation of Capital Gains u.s.45 by invoking the provisions of Sec. 47A (3) would not arise at*

**5.6** We have gone through the above detailed reply filed by the assessee and from that we are able to see that the succession was taken into effect from 27.03.2017 and all the assets and liabilities of the firm relating to the business of the firm immediately before the succession i.e on 26.03.2017 becomes the assets and liabilities of the assessee company. The assessee had enclosed the copy of the audited financial statements of the firm for the period up to 26.03.2017 at page numbers 71 to 85 in support of their contention. Similarly, the assessee also filed the summary of assets and liabilities of the firm as on 26.03.2017 in page 86 of the paper book. Even though the assessee filed number of documents, we are relying on the following documents in order to appreciate the facts.

- a) Copy of the ITR V and IT Return of the firm for the assessment year 2016-17.

- b) Copy of the Partnership Deed dt 31.01.2008 and the Indenture of Reconstitution of partnership dt 10.04.2015 and the copy of the Reconstitution of partnership dt 16.01.2017.
- c) Copy of the stamped affidavit for dissolution of firm.

**5.7** In order to appreciate the explanation offered by the assessee, we have gone through the proviso (a) to section 47(xiii) of the Act in which the words used are that “immediately before the succession”, which means that the assets and liabilities of the firm immediately before the date of succession would become the assets and liabilities of the company. In this case, the succession was taken into effect from 27.03.2017 and therefore all the assets and liabilities of the firm stood immediately before the date of succession i.e as on 26.03.2017 vests with the company. The meaning of the word immediately as given in the Black’s Law Dictionary is as follows;

“without interval of time, without delay, straight away”

**5.8** Further we found that the assets and liabilities of the firm as on 26.03.2017 i.e. immediately before succession, was transferred to the company and therefore, we are of the view that the assets and liabilities of the firm immediately before the succession were rightly transferred to the company and hence there is no violation of proviso (a) to section 47 (xiii) of the Act. The AO relied on the events that took place not immediately before the succession and therefore the findings of the AO and the Id CIT(A) are liable to be set aside. We also relied on the judgement of the Hon’ble Madras High Court reported in 90 ITR page 412 in the case of Thangam Textiles Vs First ITO, Salem wherein the phrase “immediately before” in Sec 283(2) was interpreted as “preceding the date of dissolution”.

**5.9** The AO had further relied on the transaction effected by the firm on 06.05.2016 and the deed dated 31.01.2008 and the deed of reconstitution dated 01.01.2017 and alleged that the firm had received a total consideration of Rs.394,94,99,14,233/- by selling the shares in ACT and the said consideration was later on withdrew by

the partners based on their revised shares mentioned in the unregistered deed of reconstitution dated 01.01.2017 and therefore, the entire earnings of the firm in the nature of capital gains has been withdrawn from the firm before converting the same into Private Limited company and hence the same is violative of proviso (c) to Section 47 (xiii) of the Act. The AO therefore held that the deliberate reconstitution of the firm through an unregistered deed of reconstitution and withdrawal of the surplus capital by the erstwhile partners are some glaring attempts to evade taxes. Therefore, the AO had come to the conclusion that the assessee had violated clause (a) & (c) of section 47(xiii) of the Act. In view of the withdrawal of the respective shares out of the surplus capital of the partners, the AO made an allegation that the partners have substantially derived benefit within the said succession and thus clause (c) to section 47(xiii) of the Act stands violated.

**5.10** We do not find any merit in the above finding of the AO. We have verified the balance sheet as on 26.03.2017 which was also extracted by the AO in his order and the statement showing the reserves and surplus for coming to the conclusion that the assessee had violated clause (a) & (c) of the Section 47(xiii) of the Act. The language of section 47(xiii) of the Act is very simple and it has not restricted anything done prior to the succession i.e. before 26.3.2017 and therefore, the transactions pointed out by the AO was done by the firm well before succession and not immediately before succession. In order to attract the proviso, the AO should establish the fact that the partners had received consideration or benefit other than the allotment of shares in the company. In the case on hand, there is no such evidence to show that the partners had received any consideration from the company apart from the shares. On the wrong interpretation of the provision the AO cannot assume that the assessee had violated the provisions and therefore, long term capital gains would arise for the transfer of the firm into company.

**5.11** We have also gone through the various documents filed by the assessee and found that the sale of the capital asset, i.e. shares of ACT, by the firm was made long time back and thereafter, because of the reconstitution of the firm, the surplus amounts stood in the capital account of the partners were withdrawn much before the succession and therefore we are of the view that the same could not be treated as consideration received by the partners for the transfer of the firm into a company. The firm in its normal course of business had effected the sale of shares and by no stretch of imagination it could be treated as consideration received by the partners for effecting the transfer and hence the same is also not a violation committed by the assessee in order to get the benefit prescribed u/s 47(xiii) of the Act.

**5.12** We do not find any merit in the above finding of the AO since Section 47(xiii) proviso (c) of the Act specifies that the partners should not receive any consideration or benefit directly or indirectly other than by way of the allotment of shares in the company when there is a transfer of capital assets by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm. The provision also does not authorize the AO to treat the withdrawal of capital from the erstwhile partnership firm before the succession took place as consideration received for effecting the succession. Further, there is no evidence available with the AO to show that the partners had received consideration at the time of succession and the AO also not brought out any specific instances of receiving any consideration at the time of effecting the succession. As seen from the various records, and the balance sheet, it is clear that before the transfer of the firm into a company, the partners have withdrawn their surplus share capitals and therefore, there is no evidence or any materials available with the AO to show that the partners have received consideration for the purpose of transferring the assets and liabilities of the firm to the assessee company. The

partners have withdrawn their surplus capital amount after the reorganization of the firm and not immediately before the succession and therefore, it cannot be treated as consideration received for the transfer of the assets and liabilities of the firm to the company. Therefore, we are not agreeing with the reasons adduced by the AO in order to attract proviso (c) to section 47(xiii) of the Act.

**5.13** In the present case, there are no violation of the conditions laid down in section 47(xiii) proviso (a) or (c) of the Act and therefore, the order of the AO treating the value of the assets and liabilities of the firm, as capital gain obtained by way of transfer of capital asset liable to be taxed under the head long term capital gains u/s 45(4) of the Act is not sustainable. In coming to the above conclusion, we derive assistance from the judgement of the Hon'ble Madras High Court dated 01.12.2015 in T.C (A) No.2619 of 2006 in the case of M/S CADD Centre Vs ACIT.

**5.14** The Id. CIT(A) also in his order simply extracted the findings of the AO and confirmed the order passed by the AO and therefore we are setting aside both the orders of the CIT(A) and the AO and held that the addition made under the head long term capital gains is not sustainable and hence the assessee is entitled for exemption u/s 47 (xiii) of the Act. In view of the disposal of the appeal on merits, we are not adjudicated the other grounds raised by the assessee

**6.** In the result, appeal filed by the assessee is allowed.

Order pronounced in the open court on 15<sup>th</sup> Oct, 2024

**Sd/-**  
**(Waseem Ahmed)**  
**Accountant Member**

**Sd/-**  
**(Soundararajan K.)**  
**Judicial Member**

Bangalore,  
Dated 15<sup>th</sup> Oct, 2024.  
VG/SPS

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The DR, ITAT, Bangalore.
5. Guard file

By order

**Asst. Registrar,  
ITAT, Bangalore.**