HIGH COURT OF GUJARAT

Spunpipe and Construction Co.

v.

Assistant Commissioner of Income-tax*

AKIL KURESHI AND MS. SONIA GOKANI, JJ.
SPECIAL CIVIL APPLICATION NO. 124 OF 2014
MARCH 11, 2014

Manish J. Shah *for the Petitioner.* **K.M. Parikh** *for the Respondent.*

ORDER

Akil Kureshi, J. - Petitioner has challenged notice dated 25.3.2013 issued by the respondent Assessing Officer seeking to reopen the assessment of the petitioner for the Assessment Year 2008-09. Such assessment was previously framed under section 143(3) of the Income Tax Act, 1961 ("the Act" for short), which the Assessing Officer now desires to reopen for which the impugned notice has been issued within a period of four years from the end of the relevant assessment year.

2. At the request of the petitioner, respondent supplied the reasons recorded for issuing the notice for reopening the assessment. Such reasons read as under:—

> "Verification of case record of the assessee revealed that the assessee had purchased factory land in 1994 part of which was converted into close-in-stock in 2006. The total area of the factory land purchased was 36272 sq.mtr. Out of this, land admeasuring 25282 sq.mtr. was converted into stock in trade with effect from 10.04.2006. The assessee entered into agreement with Spun Contra Developers for the purpose of development of the said 25282 sq.mtr. land by signing a development agreement on 18.11.2006. During the A.Y.2008-09, documents for 42 plots admeasuring 15310.41 sq.mtr. have been executed for sale of plots in favour of buyers for a total amount of Rs.577.81 lakh. The assessee claimed LTCG of Rs.219.05 lakh on the sale proceeds after claiming deduction u/s.54EC and 54G of the Act.
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> Out of the above claim, disallowance of Rs.297.70 lakh i.e. deduction claimed u/s.54G and computed the taxable LTCG at Rs.528.97 lakh was determined in the Assessment Order 143(3) .
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> However, the land sold being stock in trade of the assessee company who is doing the business of real estate, any income arising out of sale of the same is not a capital gain, but is an 'income from business' and hence provisions of Capital Gain would not be applicable in terms of definition of Capital assets u/s.2(14) of the Act."

3. The petitioner raised objections to the Assessing Officer reopening the assessment under communication dated 18.11.2013. It was pointed out in such objections that during the original assessment, the Assessing Officer had inquired as to why the profit on sale of capital asset should not be treated as a business income. The petitioner replied that the profit arising on sale of capital asset is long term capital gain and not business income. This reply was considered by the Assessing Officer and the profit was treated as long term capital gain. However, the petitioner's

claim for deduction under section 54G of the Act was rejected. The petitioner, therefore, contended that reopening of the assessment at this stage, now, therefore, would be based on a change of opinion. He relied on the decision of Supreme Court in the case of *CIT* v. *Kelvinator of India Ltd.* [2010] 320 ITR 561 and of this Court in the case of *Gujarat Power Corpn. Ltd.* v. *Asstt. CIT* [2013] 350 ITR 266[2012]. The petitioner also contended that the reopening at the instance of the audit party would also be bad in law.

4. The Assessing Officer, however, passed an order dated 16.12.2013 rejecting the objection of the petitioner that notice is based on the change of opinion. The Assessing Officer observed as under:—

> "3. The assessment was completed u/s.143 of the Act on 20.8.2010. Subsequently, it was noticed that before the sale of factory land by converting it into plots it was converted into stock in trade on 10.4.2006 by the assessee. Hence u/s.45(2), sale of plot will not earn capital gain but business income to the assessee. To verify this aspect the case was reopened u/s.147. Further, the reopening was made within 4 years from the end of relevant Assessment year."

5. At that stage, the petitioner filed the present petition and prayed for quashing of the notice for reopening. Learned counsel for the petitioner submitted that the land in question was held by the petitioner as a capital. The same was converted into stock-in-trade on 10.4.2006. It was later on developed, plotted and sold in partnership with other partners. In terms of section 45(2) of the Act, profit on the difference between fair market value on the date of conversion of the land and the cost of acquisition would be the capital gain in the hands of the seller but would be. charged during the year under which the stock-in-trade is disposed of. This precise question was raised by the Assessing Officer during the scrutiny assessment. The petitioner had made elaborate submissions. Only after being satisfied about the claim of the petitioner, such surplus was treated as a capital gain. The Assessing Officer, however, rejected the petitioner's claim for deduction under section 54G of the Act. Any attempt on the part of the Assessing Officer, now to revisit the issue would not be permissible.

6. Counsel also submitted that even otherwise the very premise of treating such consideration as a business income is not supported by the provisions of section 45(2) of the Act. He further pointed out that profit derived upon sale of the land by plotting it out was offered for tax by the partnership.

7. On the other hand learned counsel Mr. K.M. Parikh for the Revenue opposed the petition contending that this issue was never examined by the Assessing Officer in the original assessment. His sole inquiry was with respect to the petitioner's claim under section 54G of the Act.

8. From the record it emerges that the sole reason recorded by the Assessing Officer for issuing the impugned notice pertains to the question of treating the amount of Rs.5.77 crores (rounded off) as a capital gain or business income. This question arises in the factual background that the petitioner held a certain landed property with a factory thereon admeasuring 36272 sq.mtrs as capital asset. Out of this, land area of 25282 sq.mtrs was converted into stock-in-trade with effect from 10.4.2006. The assessee subsequently entered into an agreement with one Spun Contra Developers for developing the said piece of land by signing an agreement on 18.11.2006. During the Assessment year 2008-09, 42 plots admeasuring 15310.41 sq.mtrs were sold. Though reasons

recorded by the Assessing Officer suggested that the amount of Rs.5.77 crores represents the sale consideration of these plots; from various other documents on record, it appears that by way of total sale consideration, the petitioner company had to receive a larger amount as its share from partnership and the sum of Rs.5.77 crores represents the notional value of the land as on 10.4.2006 at the rate of Rs.351 per sq.feet (taken as fair market value as on that date) for the total area of the land sold as mentioned above.

9. This becomes particularly clear from the assessee's submission in the context of its claim for deduction under section 54G of the Act before CIT(Appeals), which reads as under:—

> "Your honour has inquired in the course of hearing about the date of transfer within the meaning of Section 2(47)(iv). The assessee company has converted the capital assets into stock in trade on 10.04.2006. Therefore, on the date of conversion, there is a transfer as per section 2(47)(iv). However, the capital gain that may arise is chargeable in the year in which the capital asset is sold. In the present case, the capital asset which is converted is sold during A.Y. 2008-2009 and the capital gain arising there from is offered for taxation. The capital asset is converted at the fair market value of Rs.351 per sq.feet on 10.04.2006. It therefore follows that the capital gain has arisen on 10.04.2006 @ Rs.351 per sq.feet. But it is sold during A.Y.2008-2009 and therefore the capital gain that has arisen is offered for taxation during A.Y.2008-2009. The land is sold during A.Y.2008-2009 by 42 separate sale deeds. The excess price realized by the developer firm over and above Rs.351 is offered for taxation business income by the developer firm. It may please further be noted that the sale deed is executed in favour of the buyer by the assessee and that the developer firm is only a confirming party. The capital asset is sold during A.Y.2008-2009. The capital gain arising there from is offered for taxation for A.Y.2008-2009. The capital gain arising there from is offered for taxation for A.Y.2008-2009 under Section 45(2). Section 2(47)(iv) talks of transfer and Section 45(2) talks of chargeability of capital gain of the said transfer in the year in which the capital asset is sold. The assessee has correctly worked out the capital gain and has offered for taxation."

10. Under such circumstances, the Assessing Officer in the reasons recorded has expressed a belief that the land sold being stock-in-trade of the assessee company any income arising out of such sale, cannot be treated as a capital gain, but must be treated as an income of the business. This very question was examined by the Assessing Officer in the original scrutiny assessment in the following manner:—

> (A) > On 16.11.2010 the Assessing Officer wrote to the petitioner as under:—
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> "'2. You have shown the book value of your land, which was converted into stock-in-trade at the value of Rs. 8,61,745. The same was sold for Rs. 9 crores (approximately). Out of the same, the land valued at Rs.5,20,193(book value) was sold for Rs. 5,77,81, 269 and the profit on this was of Rs . 5, 66, 74, 604 which you have treated as capital gains. But according to section 28 of the Income-tax Act, the same is your business income. Please give your explanation.
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> 3. Without prejudice to above, it was noticed that you have treated the profit on sale of land as long term capital gain and claimed deduction u/s.54EC and 54G. However, the same is not allowable to you in view of the provisions of section 45(2) of the Income-tax Act, 1961."

(B) In response to such query, the petitioner replied under a communication dated 21.12.2010 and contended as under:—

"7. A show cause notice is given by stating in the order sheet to the effect that since the capital gain has arisen on conversion from capital asset to stock in trade and not as a result of shifting since the purpose was to sale the assets and therefore it is stated that why Rs.5,77,81,269 being the sale proceeds received on sale of land during F.Y. 2008-2009 should be treated as business income and that why the claim under Section 54G and 54EC should not rejected.

7.1 The kind attention is drawn to provision of Section 45(2). It provides that when the capital asset is converted into stock in trade or when it is so treated then the capital gain arises in the year in which the converted land is sold and not in the year in which it is so converted. The assessee converted the capital asset into stock in trade and treated the capital assets as stock in trade during F.Y. 2006-2007. However, the converted land was sold during F.Y.2007-2008 and therefore pursuance to the provision of Section 45(2), the capital gain that has arisen is offered for taxation during A.Y.2008-2009 subject to deduction under Sec.54G and 54EC as per Sec.45 (2). It may please be noted that purpose may be anything but when the capital asset is transferred the capital gain arises. In the present case, the capital asset was converted into stock in trade during F.Y.2006-2007 and was actually transferred during F.Y.2007-2008, therefore the question of treating the same as business income does not arise. It may please be noted that what is transferred is factory land which is capital asset and not a business asset. When capital asset is transferred the gain arising there from is capital gain and not business income.

7.2 When the capital gain is offered for taxation, the assessee is entitled to deduction under Sec.54G and 54EC subject to fulfillment of the conditions. The assessee has fulfilled all the conditions laid down in Sec.54G and 54EC and therefore the question of treating Rs . 5,77,81,269 as business income does not arise."

(C) On 22.12.2010 the petitioner once again wrote to the Assessing Officer and stated as under:—

"1. It is stated in the above referred notice that book value of the land which was converted into stock in trade at the value of Rs.8,61,745 and the same was sold for Rs.9.00 Crore [approximately] . Out of which , the land worth Rs. 5,20,193 [Book Value] was sold for Rs. 5,77,81,269 and the profit on this was of Rs . 5,66,74,604 which the company has treated as capital gain. But according to Section 28, the same is the business income.

1.1 It is also stated in the above referred notice that according to Sections 45(2), the deduction under Section 54G and 54EC is not allowable."

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4. The factory land worth Rs.8,61,745 was converted into stock in trade at fair market value of Rs . 9,54,72,000 on the date of conversion as per Registered Valuer's Report. The copy of Valuer's Report is enclosed.

4.1 In the course of hearing, it is inquired why a book entry is not passed for the fair market value of Rs . 9,54,72,000 on the date of conversion. In this connection, it may please be

noted that on the date of conversion, it is fair market value of Rs.9,54,72,000 as per Registered Valuer's Report but it is not realized. You will appreciate that unless the land is actually sold and unless the price is realized, the gain that may arise cannot be transferred to capital reserve account. Again it should be noted that what is material is nature of transaction rather than book entry.

4.2 The company has already given a treatment of conversion of capital asset in the stock in trade as per the Notes Forming Part of Accounts, Clause No.12A of Tax Audit Report and Para No. 3 of Director's Report. Therefore, the passing of book entry is not relevant.

5. The factory land of book value of which is Rs.5,21,543 and not Rs.5,20,193 as stated in the Notice so converted is sold for Rs . 5,77,81,269 during A.Y.2008-2009. It is stated that the profit of Rs.5,77,81,269 should not be considered as business income under Section 28. In this connection, it may please be noted that any profit that may be earned in the course of carrying on business is taxable as business income. The assessee till date of conversion was holding the factory land as capital assets and was not carrying on any business in land and therefore the question of treating the profit as business income under Sec.28 does not arise. It should further be noted that the profit that is realized over and above the fair market value is disclosed as business profit since the assessee may carrying on business as developer after conversion and not before conversion. The profit of Rs.5.77 Crore is before conversion and not after conversion. Therefore, Sec.28 is not applicable.

It is also stated that the deduction under Sec.54G & 54EC is not allowable in view of Section 45(2). It appears that Sec.45(2) is mis-appreciated. The capital gain arises on transfer of a capital asset. The word "transfer" is defined in Section 2(47). Section 2(47)(iv) reads as under:

"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.

It therefore follows that the conversion of capital asset into stock in trade amounts to transfer. Therefore, the capital gain as arisen on conversion is chargeable under Section 45(1) but Section 45(2) provides exception. It provides that notwithstanding anything contained in Section 45(1), the capital gain shall be chargeable not in the year of conversion but in the year in which the converted land is sold. It therefore follows that Section 45(2) charges the profit on sale of converted land as capital gain tax in the year in which the converted land is sold. Section 45(2) does not provide that it shall not be charged as capital gain tax. When the profit is charged under capital gain tax, the deduction under Sec.54G and 54EC is allowable."

(D) The Assessing Officer passed order of assessment on 27.12.2010 and disallowed the petitioner's claim of deduction under section 54G of the Act observing as under:

"3.4 I have considered the reply of the assessee. The same is not tenable. The assessee has claimed exemption u/s.54G of the Income-tax Act, 1961 in respect of capital gains arising on sale of land during the year under assessment. The assessee was asked to substantiate it claim of deduction u/s.54G with all relevant and supporting documents and evidences. From the details furnished by the assessee, it is observed that the land in question is not a land used by the assessee for the purpose of its business of industrial undertaking, but was a land

which converted, as admitted and submitted by the assessee, into stock-in-trade in respect of its business as "developers". Thus, it is an admitted factual position by the assessee itself that the land in question sold during the year is not a land used for the purpose as specified in section 54G of the Income-tax Act, 1961. If is evidently clear from the provisions of section 54G that the benefit of deduction from the capital gains is available only in a case where any land, machinery or plant used for the purpose of business of an industrial undertaking. However, in the instant case, as stated hereinabove, the land formed part of stock-in-trade of the business of "developers" carried on by the assessee and not for the business of any industrial undertaking.

3.5 Further, deduction u/s.54G is allowable provided the assessee has, out of capital gains, purchased new machinery or plant or building or land etc. for the purpose of shifting of industrial undertaking to new area. Such acquisition of new machinery, plant, etc. has to be within a period of one year before or three years after the date on which the transfer took place. However, from the details as submitted by the assessee, it is not established that the assessee has industrial undertaking or has acquired any new machinery, plant etc. within the specified period of one year before or three years after the date on which transfer of land in question took place. The papers submitted by the assessee in this regard as mentioned above did not show that the assessee has set up a new industrial undertaking or has acquired any new machinery plant etc. within the specified period one year before or three years after the date on which the transfer of land took place. Therefore, even if, for argument sake, it is said that the assessee is qualifying for deduction u/s. 54G, even then, deduction is not permissible for the reason that the assessee has not complied with the mandatory provisions of section 54G.'

11. From the above documents it can be seen that during the scrutiny assessment, the claim of the petitioner for treating the income as capital gain was throughly scrutinized by the Assessing Officer. In his notice dated 16.12.2010, he pointedly inquired with the petitioner why the sum of Rs.5.77 crores (rounded off) and the profit arising out of the said sum was treated as capital gain. According to the Assessing Officer in terms of section 28 of the Act, it was the petitioner's business income. His second contention was that in any case the deduction under section 54G of the Act was not allowable. The petitioner filed detailed replies on 21.12.2010 and on 22.12.2010. In such replies, he tried to persuade the Assessing Officer on both counts, that is, on the question of treating the income as capital gain and simultaneously justifying the petitioner's claim for deduction under section 54G of the Act. The petitioner pointed out that having converted its capital asset into stock-in-trade, under section 45(2) of the Act the income upto the point of such conversion should be treated as long term capital gain. In various places in the said two communications, the petitioner raised this contention. It was only after considering such replies of the petitioner that the Assessing Officer passed the order of assessment. In such order of assessment, he gave no reasons for not treating the income as a business income instead of capital gain but gave detailed reasons why petitioner's further claim for deduction under section 54G of the Act should be rejected.

12. From the above, it clearly emerges that the Assessing Officer had a full innings of complete scrutiny of the question and the manner in which the income should be taxed. He initially held a belief that such income was a business income of the assessee. This is precisely why he called upon the assessee to explain. The assessee gave two detailed replies and relied on section 45(2) of the Act. It was only thereupon that the Assessing Officer did not change the head of the

income but made disallowance by not accepting the petitioner's claim for deduction under section 54G of the Act. Thus the Assessing Officer accepted the petitioner's claim of treating the income as capital gain. Only then the question of granting or refusing deduction under section 54G would arise.

13. It is precisely this ground which the Assessing Officer wishes to press in service for reopening of assessment. According to him such income should be treated as a business income and not capital gain. We fail to see how he can be permitted to do so. In the original assessment having examined the issue fully, any attempt on the part of the Assessing Officer to reopen the assessment would be nothing but a change of opinion.

14. We are amused by the seriousness with which the learned counsel for the Revenue contended that the Assessing Officer did not scrutinize this issue. This was the main if not the sole issue before the Assessing Officer along side the question of deduction under section 54G of the Act. The question of granting or rejecting such deduction would arise only once the petitioner's claim that such income should be treated as capital gain was accepted. It may be that the Assessing Officer did not record his reasons for accepting the petitioner's standin this respect.

This, in our opinion, would be wholly irrelevant, particularly, when the Assessing Officer, in the present case, had raised specific queries in writing, elicited the petitioner's response and thereafter, however, silently, accepted the petitioner's stand. Within four years also reopening would not be allowed in terms of the decision of the Supreme Court in the case of *Kelvinator of India Ltd.* (*supra*), in which it was held and observed as under:—

> '6. On going through the changes, quoted above, made to Section 147 of the Act, we find that, prior to Direct Tax Laws (Amendment) Act, 1987, re-opening could be done under above two conditions and fulfillment of the said conditions alone conferred jurisdiction on the Assessing Officer to make a back assessment, but in section 147 of the Act [with effect from 1st April, 1989] , they are given a go-by and only one condition has remained, viz., that where the Assessing Officer has reason to believe that income has escaped assessment, confers jurisdiction to re-open the assessment. Therefore, post 1st April, 1989, power to reopen is much wider. However, one needs to give a schematic interpretation to the words "reason to believe" failing which, we are afraid, Section 147 would give arbitrary powers to the Assessing Officer to re-open assessments on the basis of "mere change of opinion", which cannot be per se reason to re-open. We must also keep in mind the conceptual difference between power to review and power to re-assess. The Assessing Officer has no power to review; he has the power to re-assess. But re-assessment has to be based on fulfillment of certain pre-condition and if the concept of "change of opinion" is removed, as contended on behalf of the Department, then, in the garb of re-opening the assessment, review would take place. One must treat the concept of "change of opinion" as an in-built test to check abuse of power by the Assessing Officer. Hence, after 1st April, 1989, Assessing Officer has power to re-open, provided there is "tangible material" to come to the conclusion that there is escapement of income from assessment. Reasons must have a live link with the formation of the belief. Our view gets support from the changes made to Section 147 of the Act, as quoted hereinabove. Under the Direct Tax Laws (Amendment) Act, 1987, Parliament not only deleted the words "reason to believe" but also inserted the word "opinion" in Section 147 of the Act. However, on receipt of representations from the Companies against omission of the words "reason to believe", Parliament re-introduced the

said expression and deleted the word "opinion" on the ground that it would vest arbitrary powers in the Assessing Officer.'

15. Division Bench of this Court in the case of *Gujarat Power Corpn. Ltd.* (*supra*) observed as under:—

"42. Bearing in mind these conflicting interests, if we revert back to central issue in debate, it can hardly be disputed that once the Assessing Officer notices a certain claim made by the assessee in the return filed, has some doubt about eligibility of such a claim and therefore, raises queries, extracts response from the assessee, thereafter in what manner such claim should be treated in the final order of assessment, is an issue on which the assessee would have no control whatsoever. Whether the Assessing Officer allows such a claim, rejects such a claim or partially allows and partially rejects the claim, are all options available with the Assessing Officer, over which the assessee beyond trying to persuade the Assessing Officer, would have no control whatsoever. Therefore, while framing the assessment, allowing the claim fully or partially, in what manner the assessment order should be framed, is totally beyond the control of the assessee. If the Assessing Officer, therefore, "after scrutinizing the claim minutely during the assessment proceedings, does not reject such a claim, but chooses not to give any reasons for such a course of action that he adopts, it can hardly be stated that he did not form an opinion on such a claim. It is not unknown that assessments of larger corporations in the modern day, involve large number of complex claims, voluminous material, numerous exemptions and deductions. If the Assessing Officer is burdened with the responsibility of giving reasons for several claims so made and accepted by him, it would even otherwise cast an unreasonable expectation which within the short frame of time available under law would be too much to expect him to carry. Irrespective of this, in a given case, if the Assessing Officer on his own for reasons best known to him, chooses not to assign reasons for not rejecting the claim of an assessee after thorough scrutiny, it can hardly be stated by the revenue that the Assessing Officer cannot be seen to have formed any opinion on such a claim. Such a contention, in our opinion, would be devoid of merits. If a claim made by the assessee in the return is not rejected, it stands allowed. If such a claim is scrutinized by the Assessing Officer during assessment, it means he was convinced about the validity of the claim. His formation of opinion is thus complete. Merely because he chooses not to assign his reasons in the assessment order would not alter this position. It may be a non-reasoned order but not of acceptance of a claim without formation of opinion. Any other view would give arbitrary powers to the Assessing Officer.

43. We are, therefore, of the opinion that in a situation where the Assessing Officer during scrutiny assessment, notices a claim of exemption, deduction or such like made by the assessee, having some *prima facie* doubt raises queries, asking the assessee to satisfy him with respect to such a claim and thereafter, does not make any addition in the final order of assessment, he can be stated to have formed an opinion whether or not in the final order he gives his reasons for not making the addition."

16. Similar issue came up before the Full Bench of Delhi High Court in the case of *CIT* v. *Usha International Ltd.* [2012]348 ITR 485, where the reference was in the context of true interpretation of the decision of five Judge Bench of the Delhi High Court in the case of *CIT* v.

Kelvinator of India Ltd. [2002] 256 ITR 1. The Full Bench by a majority judgment, observed as under:—

> '13. It is, therefore, clear from the aforesaid position that:
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> (1) Reassessment proceedings can be validly initiated in case return of income is processed under section 143(1) and no scrutiny assessment is undertaken. In such cases there is no change of opinion.
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> (2) Reassessment proceedings will be invalid in case the assessment order itself records that the issue was raised and is decided in favour of the assessee. Reassessment proceedings in the said cases will be hit by the principle of "change of opinion".
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> (3) Reassessment proceedings will be invalid in case an issue or query is raised and answered by the assessee in original assessment proceedings but thereafter the Assessing Officer does not make any addition in the assessment order. In such situations it should be accepted that the issue was examined but the Assessing Officer did not find any ground or reason to make addition or reject the stand of the assessee. He forms an opinion. The reassessment will be invalid because the Assessing Officer had formed an opinion in the original assessment, though he had not recorded his reasons.'

17. Under the circumstance, the petition is required to be allowed on this short ground alone. Though we also have *prima facie* doubt whether in law also the Assessing Officer is correct in contending that such income should be treated as business income and not capital gain, particularly, in view of section 45(2) of the Act. We do not express any final opinion on this aspect of the matter.

18. In the result impugned notice dated 25.3.2013 is quashed. The petition is allowed. Disposed of accordingly.