IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 25TH DAY OF JUNE 2020

PRESENT

THE HON'BLE MR. JUSTICE ALOK ARADHE

AND

THE HON'BLE MR. JUSTICE M.NAGAPRASANNA

**I.T.A. NO.318 OF 2012**

BETWEEN:

1. COMMISSIONER OF INCOME TAX
(CENTRAL), C.R. BUILDINGS
QUEENS ROAD, BANGALORE 560 001.

2. DEPUTY COMMISSIONER OF INCOME TAX
CIRCLE 7(1), BANGALORE.

... APPELLANTS

(BY SRI. JEEVAN J. NEERALGI, ADV., FOR
SRI. E.I. SANMATHI, ADV.,)

AND:

SRI. C. RAMAIAH REDDY
RAMAIAH REDDY COLONY
SECTOR D, BASAVANAGAR
MARATHAHALLI, BANGALORE 560 037.

... RESPONDENT

(BY SRI. A. SHANKAR, SR. ADV., A/W
SRI. M. LAVA, ADV.,)

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THIS ITA IS FILED UNDER SECTION 260-A OF I.T. ACT, 1961 ARISING OUT OF ORDER DATED 25/05/2012 PASSED IN ITA NO.122/BANG/2011, FOR THE ASSESSMENT YEAR 2006-07, PRAYING THAT THIS HON'BLE COURT MAY BE PLEASED TO:

(I) FORMULATE THE QUESTION OF LAW STATED THEREIN.

(II) SET ASIDE THE APPELLATE ORDER DATED 25/5/2012

PASSED BY THE ITAT, 'A' BENCH, BANGALORE, IN APPEAL PROCEEDINGS ITA NO.122/BANG/2011, AS SOUGHT FOR IN THIS APPEAL.

THIS ITA COMING ON FOR HEARING, THIS DAY, **ALOK ARADHE J.,** DELIVERED THE FOLLOWING:

**JUDGMENT**

This appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act', for short) has been filed by the revenue. The subject matter of appeal pertains to Assessment year 2006-07. The appeal was admitted by a bench of this court vide order dated 08.07.2013 on the following substantial questions of law:

> *(i) Whether in the facts and circumstances of the case, the tribunal was correct in law in holding that the provisions of Section 45(2) and 49(1) of the Income Tax Act are not applicable in respect to the property received by assessee on partial partition of Hindu Undivided Family and thereby deleting the long term capital gain of RS.6,78,41,691/-?*

(ii) *Whether in the facts and circumstances of the case, the tribunal was correct in law in holding that the cost of the properties received in partial partition of HUF to be adopted as claimed by the assessee under Section 37 (1) of the Income Tax Act as deduction while computing the income under the head 'Profit and Gains of Business or Profession', ignoring the fact that the assessee did not incur any cost on such properties other than the cost incurred by the HUF at Rs.9,09,050/-?*

2. Facts giving rise to filing of the appeal in nutshell are that assessee is an individual engaged in the real estate business. The assessee filed return of income on 20.11.2006 declaring total income of Rs.1,37,71,300/-. The case was selected for scrutiny and a notice under Section 143(2) of the Act was issued. The assessee in the profit and loss account had shown purchase and sale of sites and net profit of Rs.1,13,18,182/- was shown and was declared as

income from business. Thereupon a query was made as to how the cost of the site was worked out and the assessee was asked to submit relevant documents. The assessee vide communication dated 18.12.2008 submitted copy of memorandum of family arrangement and oral partition dated 06.03.2004 wherein the details of assets and properties, which devolved upon the assessee were mentioned. The lands received by the assessee under the family arrangement were treated as stock in trade in his books and were sold in previous year. Thereupon a query was made to the assessee that capital gains on sale of such properties is attracted under Section 45(2) of the Act and since, no capital gains were offered to tax, therefore, the assessee was asked to clarify why such capital gains were not computed. The assessee was further asked to furnish original cost of acquisition of land along with purchase deeds. The assessee submitted that the values were adopted as cost or fair market values of the properties

as on the date of family arrangement held as stock in trade of real estate business of joint family. The assessing officer by an order dated 31.12.2008 inter alia held that once family partition takes place, the asset which comes in the share of the assessee par take the character of the assets in the hands of assessee as capital gains and therefore, conversion of capital assets into stock in trade and capital gains attract the provisions of Section 45(2) of the Act. The assessing officer determined the total income of Rs.8,61,37,451/- after making an addition of RS.6,78,41,691/- on account of long term capital gains under Section 45(2) of the Act on sale of lands and other assets.

3. The assessee filed an appeal before Commissioner of Income Tax (Appeals). The Commissioner of Income Tax (Appeals) vide order dated 26.11.2010 upheld the order passed by the assessing officer and dismissed the appeal. Being aggrieved, the Income Tax Appellate Tribunal by an order dated

25.05.2012 inter alia held that properties, which were held as stock in trade by the joint family before they were allotted to the respondent on partition. It was further held that the respondent continued to carry on real estate business even after partition. Thus, it was held that there was no conversion of capital assets to stock in trade either by the assessee or the joint family and therefore, the provisions of Section 45(2) of the Act were not attracted to the fact situation of the case. Accordingly, the order passed by the assessing officer was set aside and the appeal preferred by the assessee was allowed. Being aggrieved, the revenue is in appeal before us.

4. Learned counsel for the revenue submitted that the tribunal ought to have appreciated that lands belong to joint family which were subjected to partition and were allotted to the assessee and sold by him and that such a sale gives rise to capital gains and therefore, provisions of Section 45(2) of the Act are attracted. It is

further submitted that the HUF neither filed any return nor any books of accounts and also did not have any Permanent Account Number and therefore, existence of HUF itself was doubtful and the assessee was unable to prove the existence of HUF before the authorities. It is also submitted that the cost of acquisition of lands was low and cost or fair market values of the properties as on the date of family arrangement was highly inflated. The entire arrangement made by the assessee was designed to evade the tax liability. It is also urged that the findings recorded by the tribunal are perverse as the findings recorded by the assessing officer as well as the Commissioner of Income Tax (Appeals) have been reversed without there being any material on record. It is also argued that the findings recorded by the tribunal are without any basis.

5. On the other hand, learned Senior Counsel for the assessee submitted that not an iota of material was brought on record by the assessing officer to

indicate that the assets obtained were capital assets. It was further pointed out that from perusal of Clause 3 of Memorandum of Partition it is evident that asset taken over were forming part of stock in trade of real estate business. It is also urged that material on record clearly establishes that taking over of the running business including stock in trade is a pure question of fact and not question of law. It is also pointed out that even in the memo of appeal the revenue has not averred any perversity and no material has been placed on record to demonstrate that finding of fact recorded by the tribunal is perverse. It is contended that provisions of Section 45(2) of the Act are applicable only when there is a transfer of capital asset by the owner by way of conversion into stock in trade and the aforesaid condition of conversion of capital asset into stock trade is not fulfilled in the case of the assessee, therefore, provisions of Section 45(2) do not apply. It is further contended that assessee was allotted stock in trade from

the erstwhile joint family and the same continued to be held as stock in trade in the real estate business of the respondent. It is also submitted that since, the properties in question are not capital assets, therefore, provisions of Section 49(1) of the Act are not applicable to be fact situation of the case. It is also argued that from conjoint reading of Section 2(14) and Section 45(2) of the Act, it is clear that Section 45(2) is not applicable to the facts of the case and therefore, Section 49(1) of the Act does not apply to the fact situation of the case. In support of aforesaid submissions, reference has been made to decision of the supreme court in ***'KALOORAM GOVINDARAM VS. CIT', (1965) 57 ITR 335 (SC).***

6. We have considered the submissions made on both the sides and have perused the record. Before proceeding further, it is apposite to take note of the relevant provisions of the Act viz., Section 2(14), 2(47), 45(2) and 49(1) of the Act, which are reproduced below

for the facility of reference:

*2(14) "capital asset" means—*

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

*(b) xxxx*

*but does not include—*

*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 ;*

*xxxxxxx*

***2(47) "transfer",*** *means in relation to a capital asset, includes,-*

*……..*

***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 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."*

***49(1)** Where the **capital asset** became the property of the assessee-*

*(i) On any distribution of assets on the total or partial partition of a Hindu Undivided family;*

*(ii) Xxxxxxx*

*(iii) Xxxxxxx*

*(iv) Xxxxxxx*

*the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it ……., as the case may be."*

7. From perusal of Section 2(14) of the Act, it is evident that stock in trade has been excluded from the definition of capital asset and the explanation 'transfer'

as defined under Section 2(47) relates to capital assets only and does not include stock in trade. Section 49(1) of the Act is applicable when the properties in question are capital assets.

8. From close scrutiny of Section 45(2) of the Act, it is axiomatic that it is attracted only when there is a transfer by the owner of a capital asset by conversion into stock in trade. Three conditions which are sine qua non are required to be complied with in order to attract the application of Section 45(2) of the Act.

*(i) There has to be a transfer by way of conversion.*

*(ii) The conversion has to be by the owner.*

*(iii) The conversion must be of a capital asset into stock in trade.*

9. The Supreme Court in ***KALOORAM GOVINDARAM*** supra has held that except in the cases of fraud, collusion, inflation and deflation of values for ulterior purposes, cost of the asset to a divided member

must necessarily be its cost to him at the time of partition whether mentioned in the partition deed or ascertained aliunde.

10. In the backdrop of aforesaid well settled legal position, the facts in hand may be seen. From clause (iii) of memorandum of family arrangement and oral partition reads as under:

> ***3.*** *The FIRST PARTY has been allotted the balance of the capital of the family to real estate business being excess of assets over liabilities (after taking revaluation of all the assets forming part of stock-in-trade of real estate business along with the other assets pertaining to the sale business like cash in hand, bank balances etc., after allotting and providing a portion of such capital to parties No.2 to No.5 in the oral family arrangement and partition towards their respective shares to enjoyed by him in severally to the exclusion of parties No.2 to No.5 absolutely.*

11. Thus, from perusal of clause (iii) of memorandum of partition, it is axiomatic that asset, which were taken over were forming part of stock in trade of real estate business and continued to be in nature of stock in trade in the hands of the assessee. There is no iota of material on record to show that the assets obtained by the assessee were capital assets. The character of assets received on partition did not change and there is no provision in the Act to indicate that assets received on partition are capital assets, as no deeming provisions have been enacted by the Legislature. Section 45(2) of the Act are not applicable in the fact situation of the case as the asset received is stock in trade. Alternatively, it is worth noticing that there is nothing on record to indicate that any capital asset has been converted to stock in trade and provisions of Section 49(1) are not applicable to stock in trade. The definition of 'capital asset' in Section 2(14) expressly excludes stock in trade.

12. The substantial questions of law framed by this court are in fact questions of fact and the findings on the questions involved in this appeal have been arrived at by the tribunal on the basis of meticulous appreciation of material on record. The relevant extract of the order passed by the tribunal reads as under:

> *7.10 From the facts and circumstances of the case on this issue, as discussed in the preceding paragraphs, 7.3 onwards and the clear wording of the Memorandum of Family Arrangement and Oral Partition, we are of the considered view that the assessee was allotted the family's real estate business. In coming to this view, we are fortified by the decision of this tribunal in the assessee's own case for the block period referred to earlier in this order. We, therefore, hold that the assessee, on partition of the joint family, had received the balance capital of the family in the real estate business comprising various assets, which were in the nature of stock in trade and it cannot be considered that the*

*various assets or properties received by the assessee on partition are capital assets and these capital assets were converted into stock in trade of the real estate when the assessee continued to carry on the business of the erstwhile joint family. We also find as rightly contended by the assessee, that if at all there was any capital asset received on partition, such a capital asset would be the real estate business carried on by the erstwhile family.*

*8. The Assessing officer's application of the provisions of Section 45(2) of the Act to the instant case is to be examined. The provisions of Section 45(2) of the Act are attracted only when there is a conversion of a capital asset into stock in trade. As already observed by us there is no material on record to support the view taken by the assessing officer that the assessee received certain capital assets on partition of the joint family which were later converted to stock in trade by the assessee. A perusal of both the order of the Tribunal in the assessee's case in the block assessment coupled with the Memorandum of Family Arrangements and*

*Oral Partition dated 06.03.2004 clearly establishes that the erstwhile joint family of the assessee was carrying on real estate business and was holding several properties as stock in trade. These properties which were hitherto being held as stock in trade, were allotted to the assessee on partition. It is also evident that the assessee continued to carry on the said real estate business after the partition. In these circumstances, it is clear that there is no conversion of capital assets to stock in trade either by the assessee or the joint family. In this view of the matter, we hold that the provision of Section 45(2) of the Act are not applicable in the instant case and consequently the computation of capital gains made by the assessing officer is cancelled.*

13. It is well settled in law that the tribunal is a fact finding authority and a decision on the facts of the tribunal can be gone into by the high court only if a question has been referred to it, which says that the finding of the tribunal is perverse. **[SEE: 'SUDARSHAN SILKS AND SAREES VS. CIT', 300 ITR 211 (SC)]**. A

three judge bench of the supreme court in ***'SANTOSH HAZARI VS. PURSHOTTHAM TIWARI', (2001) 3 SCC 179*** while dealing with the expression 'to be a question of law involving in the case', there must be first a foundation for it laid in pleadings and the questions emerged from sustainable findings of fact arrived at by courts of fact and it must be necessary to decide that question of law for a just and proper decision of the case. In the instant case, it is pertinent to note that no factual foundation has been made in the pleading with regard to the findings of fact arrived at by the tribunal and no material has been placed on record to demonstrate that the findings of fact recorded by the tribunal are perverse. Therefore, the substantial question of law framed by a bench of this court in fact do not arise for consideration in this appeal as the matter is concluded by findings of fact.

14. In view of the preceding analysis, the appeal fails and is hereby dismissed.

**Sd/-**
**JUDGE**

**Sd/-**
**JUDGE**

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