

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Reserved on : 01.08.2016
Pronounced on : 18.04.2017

CORAM :

THE HONOURABLE MR. JUSTICE S.MANIKUMAR
and
THE HONOURABLE MR. JUSTICE D.KRISHNAKUMAR

Tax Case Appeal No. 329 of 2016

The Commissioner of Income Tax,
No.63, Race Course Road
Chennai ... Appellant

Vs.

M/s. Essorpe Holdings Pvt. Ltd.,
11A, 4th Cross, Bharathi Park Road
Coimbatore - 641 043. ... Respondent

Prayer: Appeal filed under Section 260A of Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal Madras 'C' Bench, Chennai dated 15.05.2015 in I.T.A.No.245/Mds/2015.

Appeal filed against the order in ITA.No.50 of 14-15 dated 23.12.2014 on the file of Commissioner of Income Tax(Appellate) I, Coimbatore against the assesment order made under section 143 (3) for the assesment year 2011-12 dated 31.03.2014 on the file of Assistant commissioner of Income Tax, Corporate Circle - 2, Coimbatore.

For Appellant : Mr. T.R. Senthil Kumar
Senior Standing Counsel for I.T

For Respondent : Mr. Vijaya Raghavan,
Senior Counsel for
Mr. Subbaraya Aiyar

JUDGMENT

(Judgment of the Court was made by D. KRISHNAKUMAR, J)

This Appeal has been filed by the Revenue, against the order of Madras 'C' Bench, Chennai, of the Income Tax Appellate Tribunal dated 15.05.2015 in I.T.A. No.245/Mds./2015.

2. The facts of the case are as follows :-

The respondent herein/ Assessee, is a company engaged in the business of real estate, financial services and other business. M/s. Essorper Mills Limited [EML] was demerged with the assessee company M/s. Essorpe Holdings Pvt. Ltd. [EHPL], as per the scheme of demerger, approved by this Court, transferring the real estate division of EML as a going concern. Both the companies entered into a Memo of Agreement, for a sale of 10.150 acres of land belonging to M/s. EML, for a total sale consideration of Rs.41 crores, in lieu of loan of Rs.26,50,36,747/- advanced to both the companies. Thereafter, the sale consideration was reduced to Rs.35.25 crores. The assessee company filed return of income electronically, for the assessment year 2011-12, on 16.09.2011 declaring a total income of Rs.24,71,810/-, including business loss of Rs.12,32,049/-, long term capital loss of Rs.1,17,77,478/- and income from other sources of Rs.40,26,248/-. The return was processed under Section 143(1) of the Income Tax Act and the assessee company's case was selected through CASS for scrutiny assessment. Notice under Section 143(2) of the Act dated 31.07.2012 was issued by the Assistant Commissioner of Income Tax, Company Circle I(2), Coimbatore and served on the assessee company, on 03.08.2012. The issues involved were, the sale of land and building was treated as stock-in-trade and long term capital loss on sale of zero percent non-redeemable preference shares of Essorpe Mills Ltd. (EML) held by the assessee company. The issue of transfer of land came up for the assessment with EML for the assessment year 2009-10. The sequence of events, in brief, are as follows :-

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Date	Event
28.09.1959	M/s. Essorpee Mills Limited (EML) was incorporated.
06.09.1999	EML filed application before BIFR to notify as Sick Industrial Company in the application itself, the assessee company requested the BIFR to grant permission to dispose the land belonging to the company and further submitted that the company is negotiating with prospective buyers. Simultaneously, EML negotiates best deal with Shri V. Sivakumar, a leading real estate businessman in and around Coimbatore while devising a plan to deregister the company from BIFR for the sale of the property.
02.07.2007	M/s. Essorpee Holdings Private Limited (EHPL) comes into existence.
25.02.2008	EML and EHPL enters into MOU Shri V. Sivakumar & M/s. Globuse Realtors Pvt Ltd., represented by Shri V. Sivakumar for sale of 10.150 acres of land belonging to EML for Rs.41,00,00,000/-, in lieu of loan of Rs.26,50,36,747/- to EML & EHPL between 25/2/2008 and 30/01/2009.
21.04.2008	EML gave Power of Attorney (POA) to Shri V.Sivakumar through registered document for part of land admeasuring 5.075 Acres at Sub Registrar Office, Gandhipuram, Coimbatore.
19.11.2008	BIFR de-registered the company, as requested by EML, after remitting dues with the cash obtained from Sri Sivakumar & Other.
05.01.2009 & 07.01.2009	Shri V.Sivakumar sells a part of the land to M/s. Rasi Seeds (P) Ltd. & M/s. Globuse Realtors Private Limited vide two registered documents for Rs.18,61,15,000/- and Rs.1,63,85,000/- respectively.
28.07.2009	EML applies to High Court for demerger with EHPL
09.10.2009	Obtained demerger order with effect from 01.01.2009.

Date	Event
28.04.2010	EML and EHPL enters into supplementary MOA and MOU with Shri V. Sivakumar & M/s. Globuse Realtors Pvt Ltd., represented by Shri V. Sivakumar whereby the sale consideration was reduced from Rs.41,00,000/- to Rs.35,25,00,000/-.
22.11.2010	Shri V. Sivakumar sold 5.075 acres to M/s. Globuse Realtors Private Ltd., Coimbatore for a consideration of Rs.15,00,00,000/-.

3. The assessee company filed its return for the assessment year 2011-12, bringing to tax this income on sale of land, as Long Term Capital gains. The land and building which were transferred by EHPL was never treated as investment/capital asset by the demerged company EML, due to conversion of such assets on 28.12.2007 or by the assessee EHPL since 01.01.2009, when the said company got this asset. Hence, the profit on sale of such asset will be assessed only under the head 'Profits and gains of businessman' and not under the head 'capital gains'. Profit on the said transaction is shown as below :

Sale consideration of land
(as admitted by the assessee) : Rs. 34,53,48,275.00

Less : Cost of acquisition
(as admitted by the assessee)
[indexation not available since income
from business is computed, not
capital gains] : Rs. 50,75,000.00

Business Income : Rs. 34,02,73,275.00

4. The assessee company submitted its explanation before the Assessing authority to substantiate the case that the profit on sale of the land at Saravanampatti is assessed under the head 'income from business'. Further, the assessee had submitted that M/s. Essorpe Mills Limited had converted 10.150 acres of land at Saravanampatti village, as stock in trade, on 01.04.2007. According to the assessee, as per Section 45(2) such conversion is deemed to be a transfer and the difference between the market value on the date of conversion and cost is to be assessed as capital gains. Out of the entire land, area

measuring 5.075 acres were sold in the year 2008 and the same was assessed in the hands of EML. The capital gains of the land to an extent of 5.075 acres was computed at Rs.17,84,39,545/-, out of the total consideration value of the property. However, the Assistant Commissioner of Income Tax, Company Circle I(2), Coimbatore, passed an assessment order under Section 143(3) of the Income Tax Act, 1961 dated 31.03.2014 for the assessment year 2011-12, by demanding a total taxable income of Rs.34,49,89,695/-.

5. An appeal challenging the aforesaid order, was filed before the Commissioner of Income Tax (Appeals), by raising various grounds. It is the case of the assessee company that the balance 5.075 acres of the land, development division was demerged with Essorpe Holdings Pvt. Ltd., the respondent herein, with effect from 01.01.2009, by virtue of the Order of this Court in C.P. No.213/2009. As demerger is not a transfer, under Section 47(vi)(b), the applicability of provisions of Section 45(2), is postponed till the asset is actually sold by the Transferee company. The Commissioner of Income Tax (Appeals) has rejected the appeal for the reason that plea of the assessee that the land before demerger, was converted into stock in trade by EML and so the capital gains as accrued under Section 45(2), as on the date of conversion, has to be actually charged at the time of actual sale of the land, deserves no merit. The assessee company, is a new company formed on the basis of demerger, as approved by this Court and hence the provisions under Section 45(2) of the Income Tax Act, 1961, are not applicable to the sale of land made by the assessee. By an order dated 23.12.2014, the Commissioner dismissed the appeal.

6. Aggrieved by the order of the Commissioner, an appeal was filed by the assessee company, before the Income Tax Appellate Tribunal, with a prayer to treat the entire sale consideration as capital gains, instead of treating as business profit, on the following among other grounds :-

1. At the time of transfer, Essorpee Holdings Private Limited treated the land holding as investment and so the sale consideration should have been considered as capital gains.
2. The Commissioner of Income Tax (Appeals) has not appreciated the fact that the assessee has converted the stock of land into investment through the Board's resolution and accordingly the entire profit should be assessed as capital gains.

3. On various grounds, the Commissioner of Income Tax (Appeals) has not appreciated the provisions under Section 45(2) of the Income Tax Act.

The Tribunal has observed that based on the market value upto the date of conversion i.e., in the year 2007, the profit should be assessed as capital gains under Section 45(2) and the balance assessed as business profits. The Tribunal has also relied upon the order passed by the co-ordinate Bench of the Tribunal, for the assessment year 2009-10, in the case of M/s.Essorpe Mills Ltd. & Ors., in ITA No.2256/Mds/2012 dated 11.07.2013, wherein it has been observed as follows, in paragraphs 8 and 9 :-

" 8. Heard both sides. Perused the orders of the lower authorities and records. The Commissioner of Income Tax (Appeals) in his elaborate order considered the submissions of the assessee as well as contentions of the Assessing Officer and arrived at a conclusion that there is a transfer within the meaning of Section 2(47) of the Act in respect of the property and income had arisen during the assessment year 2009-10. However, since the assessee has converted the capital asset into stock-in-trade, he has directed the Assessing Officer to calculate the business income on the sale of 5.075 acres of land by the assessee company for the assessment year 2009-10. however, he directed the Assessing Officer to take 50% of Rs.35,25,00,000/- as sale consideration in respect of total property of 10.150 acres of land for the assessment year 2009-10 as business income on account of transfer of property. The counsel for the assessee could not substantiate his claim that there is no transfer and no income had arisen during the assessment year 2009-10 and at the same time, has no serious objection in assessing gain as business income, as per the provisions of Section 45(2) of the Act. The assessee has not seriously objected for considering the sale consideration for the assessment year 2009-10 at Rs.20,25,00,000/- as against the direction given by the Commissioner of Income Tax (Appeals) to adopt at Rs.17,62,50,000/-.....

9. Therefore, we uphold the order of the Commissioner of Income Tax (Appeals) as far as assessing the income in respect of transfer of property of the assessee as business income. However, the gain on transfer of property up to the date of conversion into stock-in-trade has to be assessed under the head "capital gains" and the gain in respect of property i.e. after the date of conversion into stock-in-trade has to be assessed as business income. As the Assessing Officer computed the entire sale consideration under the head long term capital gains, he did not apply the provisions of Section 45(2) of the Act. In the circumstances, we direct the Assessing Officer to compute the business income in respect of stock-in-trade of the property taking into consideration the provisions of section 45(2) of the Act in accordance with law after giving an adequate opportunity of hearing to the assessee in the light of the submissions made by the assessee before us."

In view of the above observations, the appeal filed by the assessee/ respondent therein, was partly allowed by the Tribunal.

7. Challenging the aforesaid order passed by the Tribunal, the Revenue has filed the instant appeal before this Court, which was admitted on 26.07.2016, on the following substantial questions of law :-

1. Whether on the facts of the case, the Appellate Tribunal was right in holding that the land was to be treated as capital asset upto conversion of it into stock in trade and liable for capital gain under Section 45(2) and when the assessee actually sold the land the same is to be assessed as "Business Income" for the assessment year 2011-12 ?
2. Whether on the facts of the case, the Appellate Tribunal was right without considering the character of land which was qualified as stock in trade in the annual accounts and balance sheet for the period ended 31.03.2010 and 31.03.2011 can be altered by a mere board resolution ?"

8. Learned Senior Standing Counsel for the appellant Revenue would submit that the Assessing Officer taxed the entire

sale consideration as "income from business" and not under the head "capital gains" from the sale of a building. Consequently, the assessee's claim of long term capital loss, on the sale of zero percent non-redeemable preference shares of M/s. EML, was not allowed to be set off, since the sale consideration on 10.150 acres of land was taxed under the head of 'business income' and not under the head of 'capital gains'. The Commissioner of Income Tax (Appeals) in ITA No. 50/14-15, has upheld the action of the Assessing Officer on the issue of short term capital gain, on sale of building and denial of setting off, the long term capital loss. Hence, reversing the order of the Commissioner by the Appellate Tribunal is not proper and so prayed to allow the present appeal, filed by the Revenue. Learned counsel further submitted that the asset was converted into stock in trade on 28.12.2007 in the hands of M/s. Essorpe Mills Limited and Essorpe Holdings Private Limited, got demerged subsequently on 01.01.2009, as per the order of this Court. The fact that the character of land, which was qualified as stock in trade in the annual accounts and balance sheet, for the period ended 31.03.2010 and 31.03.2011 can be altered by a mere board resolution, has not been considered by the Tribunal. Therefore, the order of the Tribunal is unsustainable in law. The application of Section 45(2) was limited only to EML and not EHPL. Therefore, the order of the Tribunal is liable to be set aside, on the said questions of law, raised by the assessee.

9. It is also submitted that both the companies, EML and EHPL, have the same Board of Directors and so the Board's resolution dated 01.04.2010 has got no legal sanctity and when the audited accounts of the EHPL for the period 31.03.2010 and 31.03.2011 are already available with the Revenue, which evidence that the land to an extent of 5.075 acres was held as stock in trade only and the Board's resolution is only a colourable device, to avoid taxation. The sale of 5.075 acres of land has to be brought to tax as 'business income' only and not under 'capital gains'. Therefore, allowing the benefit of Section 45(2) of the Act, to the assessee EHPL, has no application to the facts of the instant case. The benefit of Section 45(2) of the Act can be given to the owner of the land, namely, EML and by virtue of demerger on 01.01.2009, EHPL had taken over the land measuring 5.075 acres as stock in trade for the purpose of carrying out real estate business and hence it has to be rightly assessed as business income and not as capital gains. Therefore, the order of the Tribunal has to be set aside and the substantial questions of law framed by this Court, are to be answered in favour of the Revenue.

10. Per contra, learned counsel for the assessee would submit that the land in question was originally treated as investment and converted into stock in trade from 28.12.2007, by the Transferor company EML. The said conversion being accepted

by the Revenue, the legal consequences of conversion of land/ investment into stock in trade, are as under :-

" Under Section 45(2) there is a deemed transfer and capital gain being the difference between the market value and the cost of acquisition becomes chargeable on the date of conversion. But the section postpones the charge of tax to the date of actual transfer/sale of such stock in trade.

The capital gains accruing on conversion of the land in stock in trade has been determined in the hands of EML and the computation has not been questioned by the department. This capital gain as per Section is to be charged to tax on the date of sale or transfer of the stock in trade. But this postponed levy does not alter the character of the converted asset, which will be a stock in trade after conversion, as Section 45(2) itself recognises."

11. Further, learned counsel appearing for the assessee would submit that demerger from EML to EHPL should not be considered as sale or transfer. If such demerger is considered as sale or transfer, the entire amount should have been assessed in the hands of EML itself. Therefore, the provisions of Section 45(2) will become applicable since the land is sold by the assessee. The provisions of Section 45(2) is a charging section for capital gains. It will apply, whenever a land, which originally treated as investment and later converted into a stock in trade, is sold or transferred. Further, he submitted that it is not the case of the Revenue that the converted land was sold or transferred earlier. Hence, the charge of capital gains was rightly levied at the time of sale of land by the assessee. Hence, the Tribunal was correct in holding that provisions of Section 45(2) is applicable to the case of assessee. Learned counsel for the assessee company would submit that the assessee took the land as stock in trade and when the land was sold also it was treated as stock in trade and the entire sale consideration of Rs.15 crores was assessed under the head profits and gains of business, which is over and above the capital gains, levied under Section 45(2). When the land was converted as stock in trade, then the cost of acquisition of the stock in trade, is the market value on the date of conversion. The decisions in the case of Commissioner of Income Tax v. Groz-Beckert Saboo reported in 116 ITR 125 SC and the case of Commissioner of Income Tax v. Ambadi Enterprises reported in 243 ITR 431 Mad., have been relied by the assessee. As per the decisions, when the assessee had taken the property on demerger as stock in trade, the cost of acquisition of such

property should be taken at the market value, as on the date of conversion. Therefore, notwithstanding levy of capital gains under Section 45(2), the land sold should be taken as stock in trade, treated as stock in trade and sold as stock in trade. The interim Board Resolution of the assessee reconverting the land from stock in trade into investment, was not accepted by the Assessing Officer, Commissioner of Income Tax (Appeals) and the Income Tax Appellate Tribunal. In fact, the Assessing Officer, while giving effect to the order of the Tribunal, has treated the entire sale consideration of the land, Rs.15 crores, as business income as per the directions of Commissioner of Income Tax (Appeals). The said portion of the order has not been altered in the decision of the Tribunal and the same has become final. Under Section 45(2) of the Act, under which capital gains are deemed to accrue at the time of conversion of investment into stock in trade, the actual levy is postponed to the time of actual transfer or sale. So, levy of capital gains under Section 45(2) is only levy of capital gains, which has been already accrued but only the time of its levy is postponed. Merely because capital gains under Section 45(2) is charged, it does not mean it alters the character of the asset converted. Such converted asset continues to be only as stock in trade, despite levy of capital gains under Section 45(2).

12. It is further submitted that the Revenue has misunderstood the import of Section 45(2) because it relates to capital gains conversion of investment, into stock in trade but postpones the charge of tax to the time, such stock in trade is sold or transferred. Once converted into stock in trade, the asset will continue to be treated as stock in trade, as mentioned in the section itself. Application of provision of Section 45(2) will not reconvert the converted stock in trade, back into an investment. Consideration of sale of such converted asset will always be assessed as profits of business. Further, learned counsel for the assessee would reply to the grounds raised by the Revenue that the land was received as stock in trade and sold as stock in trade. Capital gains under Section 45(2) which accrued on conversion is now levied at the time of sale. Application of statutory provision of Section 45(2) cannot be ignored. Levy of capital gains under Section 45(2) is in addition to and does not affect the entire sale price of the land being treated as business income. The land in question was received as stock in trade and treated as stock in trade and entire sale consideration is assessed under the head business income. The land was not treated as investment. In view of the above, learned counsel for the assessee submitted that the grounds raised by the Revenue is misconceived.

13. Further, as per Section 45(2), the capital gains

accrued on conversion of investment into stock in trade and only the taxation is postponed to the time when the stock in trade is transferred or sold. It is not disputed by the Revenue that demerger is not a sale or transfer, as otherwise the capital gains should have been levied at the time of demerger. Therefore the capital gains computed under Section 45(2) at the time of conversion on 28.12.2007 has been properly brought to tax when the land was sold by the assessee. Levy of capital gains under Section 45(2) is not a benefit but an additional levy over and above the assessable of the entire sale consideration of land as business profits. On sale of an investment converted into stock in trade, two independent taxes are levied :

- i. Capital gains accruing on the date of conversion, omitted to be charged at the time of conversion, is brought to tax under Section 45(2) at the time of a actual sale / transfer of the stock in trade.
- ii. Independent levy of capital gains under Section 45 (2), the entire sale consideration of stock in trade will be assessed under the head business income. The cost of acquisition for the stock in trade will be the market value of the land as on the date of conversion.

This method of computation has been adopted in computing profit, on sale of half portion of 5.075 acres, in the hands of the transferor EML, which has been accepted by the Revenue.

14. Learned counsel appearing for the assessee company, invited our attention to the giving effect order dated 24.07.2015 passed by the Deputy Commissioner of Income Tax, Corporate Circle-2, Coimbatore, passed pursuant to the order of the Income Tax Appellate Tribunal dated 15.05.15 (without prejudice to the submission made on the merits of the case) and submitted that whatever be the substantial questions of law, for which answer is sought for, under Section 260A of the Income Tax Act, 1961 in the Giving Effect Order, the Assessing Officer himself has granted the reliefs, as prayed for.

15. Learned counsel for the assessee submitted that in view of the above, there is no substantial questions of law involved in the appeal and hence the order of the Tribunal is perfectly valid and the appeal is liable to be dismissed.

16. Heard Mr. T.R. Senthil Kumar, learned Senior Standing Counsel for the appellant Revenue and Mr. Vijayaraghavan, learned senior counsel for the respondent assessee and perused the material available on records.

17. The Assistant Commissioner of Income Tax, Company Circle I(2), Coimbatore, passed an assessment order under Section 143(3) of the Income Tax Act, 1961 dated 31.03.2014 for the assessment year 2011-12, by demanding a taxable income of Rs.34,02,73,275/- being the sale consideration received for transfer of 5.075 acres of land, by including the income received from other sources and determined the total taxable income of Rs.34,49,89,695/-. Aggrieved by the assessment order, the assessee company filed an appeal in I.T.A. No.50/14-15 before the Commissioner of Income Tax (Appeals)-1, Coimbatore. The Commissioner, dismissed the appeal, in so far it relates to the transfer of land by the assessee company as the provision of Section 45(2) of the Income Tax Act, 1961 is not applicable to the sale of land, made by the assessee. Challenging the order of the Commissioner dated 23.12.2014, the assessee went on appeal before the Income Tax Appellate Tribunal in ITA No.245/Mds/2015, stating that the land was originally converted as stock in trade on 01.04.2007 and so the profit on sale of land or the gain determined on the date of conversion, under Section 45(2), should be assessed as capital gains and the balance as business profit.

18. Further, the assessee pleaded that Section 45(2) of the Income Tax Act 1961 would apply to the present case. Therefore, by considering the submissions of the assessee as well as the representative of the Revenue department, the Tribunal has observed as follows :-

" 8. Therefore, in our opinion, the land was to be treated as capital asset upto conversion of it into stock in trade and the assessee is liable for capital gain on conversion of it as stock in trade and so the provisions of Section 45(2) is applicable. After the conversion of the land, when the land was actually sold, the assessing officer computed the entire sale consideration under the head 'business income' he did not apply the provisions of Section 45(2) of the Act, which is not proper. Hence, the Assessing Officer was directed to compute the capital gains upto the date of conversion into stock in trade, by applying provisions of Section 45 (2) of Act and thereafter on actual sale of the land i.e. difference between the value of sale and stock in trade to be considered as 'business income' and to be assessed in this assessment year, accordingly."

19. The land in question was originally treated as

investment and was subsequently converted as stock in trade from 28.12.2007 by the Transferor company EML. The aforesaid conversion was accepted by the department. The department on scrutiny of the case of the assessee company, under Section 143 (3) of the Income Tax Act, 1961, assessed the income tax of the assessee for the entire sale consideration of Rs.15 crores, under the head profits and gains of business. The assessment officer has computed the sale of land under "business income" and therefore rejected the claim of the assessee to compute the capital gains under Section 45(2) of the Act. It is useful to refer Section 45(2) of the Income Tax Act, 1961, which reads as follows :

" 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."

20. In the assessment order, it has been observed by the Assessing officer that the assessee company has borrowed a sum of Rs.35.25 crores over a period from M/s. Globuse Realtors Pvt. Ltd. The aforesaid borrowings was secured by the property of EML, with an understanding that the lenders can enforce the sale of the land, in the event the assessee was not able to repay the loan. The assessee invested part of the borrowings as preference shares in EML, who has converted its entire land holding 10.150 acres into stock in trade, as on 01.04.2007. Consequently, the entire land of 10.150 acres, held by EML was deemed to have been transferred under Section 45(2) and the capital gains accrued on such conversion computed with the market value as on date of conversion of the land being treated as full value of consideration. The deemed capital gains on the date of conversion amounted to Rs.38,25,57,889/- for the entirety of 10.150 acres and the same was chargeable to tax on the actual sale of the said converted land. The real estate division of EML was demerged into the assessee company, as per the Scheme of demerger approved by the High Court with effect from 01.01.2009. Pursuant to the approved scheme, the land held by EML was demerged and vested with the assessee. After demerger, the assessee company had converted the land into investments from 01.04.2010 as supported by a resolution of the

Board of Directors dated 01.04.2010. Thereafter, the assessee company disposed of the land to an extent of 5.075 acres through Power of Approval (POA), for a sale consideration of Rs. 15 crores, with which the loan outstanding amount was settled to the borrowers. The assessee has offered the gain on transfer of the entire 10.15 acres of land as long term capital gains and set it off against the long term capital loss incurred by the assessee. The assessing officer assessed the entire sale consideration as business profit on the ground that the land was shown as stock in trade. According to the assessee, the land demerged with EML to EPHL, is not a transfer, in view of the provisions of Section 47(vib) of the Act, which reads as follows :-

"Transactions not regarded as transfer.

47. Nothing contained in Section 45 shall apply to the following transfers :-

.....

(vib) any transfer, in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company; "

21. A part of the land measuring 5.075 acres, out of the total extent of 10.150 acres, were sold even before filing the demerger application before this Court. The aforesaid sale was not brought to the notice of the High Court. The High Court of Madras, as per the Scheme of Demerger approved EML demerging with M/s. EHPL, transferring the real estate division of EML to EHPL as a going concern. As on 31.03.2010, the assessee company has shown the land in question as stock in trade and the same was later converted as Fixed Asset, by the Board Resolution. In the case of sale of 50% of the same property, out of 10.150 acres of land, for the assessment year 2009-10 was considered, by the co-ordinate Bench of the Tribunal in the case of M/s. Essorpe Mills Ltd., in ITA No. 2256/Mds/2012 dated 11.07.2013, wherein it was held that the gain on transfer of property up to the date of conversion into stock-in-trade has to be assessed under the head "capital gains" and the gain in respect of property i.e. after the date of conversion into stock-in-trade has to be assessed as business income. As the Assessing Officer computed the entire sale consideration under the head long term capital gains, he did not apply the provisions of Section 45(2) of the Act. Therefore, the Assessing Officer should compute the business income in respect of stock-in-trade of the property, taking into consideration the provisions of section 45(2) of the Act, in accordance with law, after giving adequate opportunity of hearing to the assessee.

22. The provisions of Section 45(2) is a charging section for capital gains. It will apply, whenever a land, which originally was treated as investment and later converted into a stock in trade, is sold or transferred. So the land in this case was converted into a stock in trade in the hands of EML and as demerger is not a transfer, the capital gains under that section is charged when the land was sold by the assessee company. The capital gains accruing on conversion of the land in stock in trade can be determined in the hands of EML and the computation cannot be questioned by the department. Levy of tax is postponed at the time of actual transfer or sale. Under Section 45(2) of the Act, the section charges to capital gains conversion of investment, into stock in trade but postpones the charge of tax to the time, such stock in trade is sold or transferred. Once converted into stock in trade, the asset will continue to be treated as stock in trade, as mentioned in the section itself. Application of provisions of Section 45(2) will not reconvert the converted stock in trade back into an investment. Consideration of sale of such converted asset will always be assessed as profits of business. The said provision was interpreted by the Assessing Officer under the said section.

23. Following the decision of this Court, in the case of Commissioner of Income Tax vs. Ambadi Enterprises Ltd., reported in (2000) 243 ITR 0431, wherein it is held as follows :-

" The Tribunal has also found that the land had not been developed earlier and that the investment made by the assessee in the year 1968 was only by way of investment and not to treat the lands as its stock-in-trade. The money required for the purchase of the land had come out of the funds which had been lent to it by a sister company as loan or deposit. Instead of keeping the money as deposit or by lending the money to others, it had chosen to invest that money on land, and holding the land as an investment. It was only in the year 1972, the company decided to treat the same as its stock-in-trade, developed the same and after effecting such development, the land was sold in small parcels on a profit. The Tribunal has also observed in its order that lands as in the year 1972 could be held either as an investment or stock-in-trade and that the assessee had held it as investment till July 6, 1972, and it is only thereafter that it had treated the land as its stock-in-trade. the Tribunal's view that for finding out the business profit for the sale of lands, the market value on the date of conversion of the asset from investment to

business asset should be taken and not the original price for which the assessee purchased the property is sustainable in law ."

The decision of the Hon'ble Supreme Court in the case of Commissioner of Income Tax vs. Groz-Beckert Saboo Ltd., reported in (1979) 8 CTR 0155, wherein an assessee converts his capital assets into stock-in-trade and starts dealing in them, the taxable profit on the sale must be determined by deducting from the sale proceeds the market value at the date of their conversion into stock-in-trade and not the original cost of the assessee. In paragraph 2, it has been held as follows :-

" 2.There can, therefore, be no doubt that these raw materials and semi-finished needles were received by the assessee as capital assets and subsequently on 30th Sept., 1961, they were transferred to the business as part of its stock. If that be so, the cost of these raw materials and semi-finished needles to the business could not be said to be nil, but, on the principle laid down by this Court in CIT vs. Bai Shirinbai K. Kooka (1962) 46 ITR 86 (SC) : TC14R.129, and subsequently followed in CIT vs. Hantapara Tea Co. Ltd. (1973) 89 ITR 258 (SC) : TC17R.1227, it would be the market value of these raw materials and semi-finished needles as on 30th Sept., 1961. It is now well settled by these decisions that where an assessee converts his capital assets into stock-in-trade and starts dealing in them, the taxable profit on the sale must be determined by deducting from the sale proceeds the market value at the date of their conversion into stock-in-trade (since this would be the cost to the business) and not the original cost to the assessee. "

24. Therefore, in the light of the decisions rendered by this court as well as the Hon'ble Supreme Court and the orders passed by the coordinate bench of the Income Tax Appellate Tribunal, in the case of ITA No. 2256/Mds/2012 dated 11.07.2013 wherein the revenue has accepted the sale of 50% of the same property by the Essorpe Holdings Pvt. Ltd., to an extent of 5.075 acres of land for the assessment year 2009-10, directing the Assessing Officer to apply the provisions of Section 45(2) of the Act and compute the capital gains upto to the date of conversion into stock in trade, and thereafter on actual sale of the land i.e. the difference between the value of sale and stock in trade to be considered as " business income".

25. It is also brought to our notice that pursuant to the orders passed by the Tribunal on 15.05.2015, the Deputy Commissioner of Income Tax, Corporate Circle-2, Coimbatore has passed an order in proceedings No. PAN:AABCE9372R dated 24.07.2015, by computing the assessment of the assessee, applying the provisions under Section 45(2) of the Income Tax Act, 1961, had modified the total income of the assessee respondent, as follows:-

Loss from business (on sale of 5.075 acres land and on application of Section 45(2) of the Act as worked out in Para.3.2 above		(-) 2,90,73,864
Short Term Capital Gains as per assessment order u/s 143(3) of the Act dated 31.03.2014		7,15,172
Income from other sources as per assessment order u/s 143(3) of the Act dated 31.03.2014		40,26,248
Nett Loss from business		(-) 2,43,32,444
Less: Deduction u/s 80G		25,000
Net Loss from business allowed to be carried forward		(-) 2,43,57,444
LONG TERM CAPITAL GAINS/LOSS		
Long Term Capital Gains on sale of 5.075 acres of land and on application of section 45(2) of the Act as worked out in Para 3.2 above.	17,84,39,549	(-) 14,26,02,954
Less: Long Term Capital Loss on zero% non-convertible redeemable preference shares of M/s.EML as per return of income and as per assessment order u/s 143(3) of the Act dated 31.3.2014	(-) 32,10,42,503	

26. The Deputy Commissioner of Income Tax, Corporate Circle-2, Coimbatore, in the above said order has modified the total income of the assessee/ respondent. The said fact is also placed on record before this Court.

27. In the light of the aforesaid discussions and decisions cited supra and in view of the order passed by the Deputy Commissioner of Income Tax Appeal, the substantial questions of law framed under Section 260A of the Income Tax Act 1961 is answered against the Revenue. Accordingly, TCA No. 329 of 2016 is dismissed. No order as to costs.

Sd/-
Assistant Registrar

//True Copy//

Sub Assistant Registrar

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To

1. The Commissioner of Income Tax,
No.63, Race Course Road
Chennai.
2. The Income Tax Appellate Tribunal, D-Bench,
Chennai.
3. The Chief Commissioner of Income Tax (Appeals-1),
Corporate Range, Coimbatore.
4. The Additional Commissioner of Income tax,
Corporate range, Coimbatore.
5. The Assistant Commissioner of income Tax,
Corporate Circle-2, Coimbatore.

+1cc to Mr.T.R.Senthil Kumar, Advocate, S.R.No.23548

+1cc to Mr.Subburaya Aiyar, Advocate, S.R.No.23599

Tax Case Appeal No.329 of 2016

KS (CO)
RS (27/06/2017)