IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO. 807 OF 2018

Pr. Commissioner of Income
Tax – 10 ….Appellant

V/s.
Nilkanth Tech Park Pvt. Ltd. …Respondent

Mr. Akhileshwar Sharma for Appellant.
Ms. Vasanti B. Patel for Respondent.

CORAM : K.R. SHRIRAM &
NEELA GOKHALE, JJ.
DATED : 4th OCTOBER 2023

P.C. :

1. The following substantial questions of law are proposed :

QUESTION OF LAW

1. Whether on the facts and in the circumstances of the case and in Law, the Hon'ble ITAT was justified in holding that the order passed by Ld. CIT does not fulfill the twin conditions as contemplated u/s. 263 of the Income Tax Act, 1961, without appreciating that the allowability of claim of the assessee by the Assessing Officer was not in accordance with law, which justifies to term the assessment order as erroneous and prejudicial to the interest of Revenue?

2. Whether on the facts and in the circumstances of the case and in Law, where there was no discussion in the assessment order of the Assessing Officer about the dealing with Explanation to section 73 of the Income Tax, 1961, the Commissioner of Income Tax had rightly initiated proceedings u/s. 263 of the Income Tax Act, 1961 as the allowability of loss without applying Explanation to section 73 of the Income Tax Act, 1961 and section 45(2) of the Income Tax Act, 1961 was without application of mind by the Assessing Officer?

2. In the statement of facts in the appeal it is stated that respondent/assessee is engaged in the business of manufacturing of chemicals. Mr. Sharma stated that assessee is in real estate business. The

assessee filed return of income for Assessment Year 2009-10 on 29th September 2009 declaring total income at loss of Rs.4,88,18,926/-. The assessment was completed under Section 143(3) of the Income Tax Act, 1961 (the Act) and an assessment order dated 17th November 2011 came to be passed.

3. Thereafter, appellant issued a Show Cause Notice dated 4th March 2014 under Section 263 of the Act calling upon assessee to show cause as to why the assessment made by the Assessing Officer (A.O.) should not be cancelled/set aside to the extent as mentioned in the notice. Paragraph No.2 of the notice reads as under :

> *2. On going through the details filed by the assessee company during the course of assessment proceedings, it was seen that the assessee company had converted its investment of 3,00,000 shares of S.P.S. Limited amounting to Rs.5,75,70,135/- into stock-in-trade which were sold on 30.03.2009 for a consideration of Rs.96,55,125/-. The loss arising from this transaction was claimed by you as a loss under the head 'business'. The assessing officer assessed the said loss at Rs.4,49,03,946/- and allowed it to be carried forward as development and there has been no change in its nature of business during the year, the provisions of the Explanation to section 73 of the Act are squarely applicable to the share trading transactions carried out by the assessee during the year under consideration. Since the Assessing Officer has treated share trading loss as business loss while completing the assessment, the order passed u/s. 143(3) on 17.11.2011 is erroneous and prejudicial to the interest of revenue.*

4. Assessee replied to the Show Cause Notice and appellant rejected the submissions of assessee and concluded that the order passed by the A.O. was erroneous and prejudicial to the interest of assessee. Appellant set aside the assessment order and directed the A.O. to pass the assessment

order afresh by applying the provisions of Section 45(2) of the Act to the conversion of share from investment or capital asset to stock-in-trade. The loss was directed to be treated as a speculation loss. The order dated 24th March 2014 passed by appellant under Section 263 of the Act was impugned before the Income Tax Appellate Tribunal (ITAT). Various grounds were taken before the ITAT. Apart from the ground that CIT erred in applying provisions of explanation to Section 73 of the Act and thereby treating the loss as speculative, it was also urged that CIT erred in passing the order under Section 263 of the Act on the issue of Section 45(2) of the Act and treating loss as capital loss without raising the issue in the Show Cause Notice. Assessee also urged that the order of CIT was mere change of opinion and hence erroneous.

5. The ITAT, after considering the submissions made by parties, by an order dated 19th May 2017 set aside the order of CIT for various reasons but one of the primary grounds for interfering was that the twin conditions for exercising jurisdiction under Section 263 of the Act, viz., order of the Assessing Officer (A.O.) being erroneous and that was prejudicial to the interest of Revenue being conjunctive, have not been met. Further, in the notice there was not even a reference to Section 45 (2) of the Act. In the order passed by CIT, Paragraph Nos.5 (b), 7, 7.1 and 8 read as under :

> *xxxxxxxxxx*
> *5(b) The provisions of section 45(2) of the Act provide that if a capital asset is converted into stock-in-trade and stock-in-trade is sold or otherwise transferred by the assessee, then for the purpose*

of section 48, the fair market value of the asset on the date of conversion shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital assets. Since the shares were held by the assessee as investment and converted into stock-in-trade during the previous year relevant to A.Y. 2009-10, the difference between the fair market value on the date of conversion and the cost/indexed cost of acquisition is liable to be treated as capital gains and the difference between the fair market value on the date of conversion and the actual sale consideration would be business income/loss and in the event of loss, the same would be liable to be treated as per the explanation to Section 73 of the Act.

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7. The nature of assessee's real estate business is such that the revenue receipts are not consistent bu received in large chunks normally after a project is complete. If the assessee's argument is accepted, it will result in a ridiculous situation with the company's nature of business changing with each year. A major construction company which had no projects complete during a year but earned dividends on fixed deposits would be considered as a financial/investment company in that year.

7.1 In addition, it should be borne in mind that in A.Y. 2008-09, the immediately preceding A.Y., the assessee had accepted that loss in shares was speculation loss. It has also been noted that the provisions of section 45(2) had not been followed. According to the provisions of section 45(2) of the Act provide that if a capital asset is converted into stock-in-trade and stock-in-trade is sold or otherwise transferred by the assessee, then for the purpose of section 48, the fair market value of the asset on the date of conversion shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital assets. Since the shares were held by the assessee as investment and converted into stock-in-trade during the previous year relevant to A.Y. 2009-10, the difference between the fair marker value on the date of conversion and the cost/indexed cost of acquisition is liable to be treated as capital gains and the difference between the fair market value on the date of conversion and the actual sale consideration would be business income/loss and in the event of loss, the same would be liable to be treated as per the explanation to Section 73 of the Act.

8. In view of the above, the assessment made by the Assessing Officer is set aside to be made afresh applying the provisions of sec. 45(2) to the conversion of shares from the investment or capital assets to stock-in-trade. The loss incurred in the conversion at fair market value viz-a-viz cost of acquisition will be treated as long term capital loss, the loss incurred on the subsequent sale of the shares would be treated as speculation loss.

6. It is therefore, very clear that in the Show Cause Notice quoted earlier, there is no discussion or even reference to Section 45 (2) of the Act and assessee has not been given an opportunity to explain as to why the provisions of Section 45(2) of the Act should not be applied to the conversion of shares from investment or capital asset to stock-in-trade.

7. Section 263(1) of the Act reads as under :

> *Section 263(1) - The [Principal Chief Commissioner or Chief Commissioner or Principal Commissioner] or] Commissioner may call for and examine the record of any proceeding under this Act, and if he considers that any order passed therein by the [Assessing] Officer [or the Transfer Pricing Officer, as the case may be,] is erroneous in so far as it is prejudicial to the interests of the revenue, he may, after giving the assessee an opportunity of being heard and after making or causing to be made such inquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, [including -*
>
> *(i) an order enhancing or modifying the assessment or cancelling the assessment and directing a fresh assessment; or*
>
> *(ii) an order modifying the order under section 92CA; or*
>
> *(iii) an order cancelling the order under section 92CA and directing a fresh order under the said section].*

Therefore, the Commissioner may call for or examine the record of any proceeding if he considers that any order passed therein by the A.O. is erroneous in so far as it is prejudicial to the interests of the Revenue. Once he is satisfied that the order passed by the A.O. is erroneous and it is prejudicial to the interest of Revenue, before he passes any order as the circumstances of the case may justify including an order enhancing or modifying the assessment or cancelling the assessment and directing a fresh assessment, an opportunity should be given to assessee of being heard. If there is no reference to provisions of Section 45(2) of the Act in the notice issued under Section 263 of the Act, it is obvious that such an opportunity of being heard has not been given to assessee.

8. In the circumstances, on this ground alone, the order passed by the CIT should be quashed and set aside.

9. Moreover, the ITAT has proceeded to dispose the matter on merits and come to the conclusion that the very same issue of converting the capital asset into stock-in-trade was the subject of query raised during the assessment proceedings. The ITAT came to the conclusion that the assessment order has been passed by the A.O. by application of mind and after considering the response of assessee. Revenue has not disputed the replies that were placed by assessee before the A.O.

10. A point was raised by Mr. Sharma that there is no discussion on this in the assessment order. It is settled law as held in the judgment of this court in ***Aroni Commercials Ltd. vs. Deputy Commissioner of Income Tax - 2(1)***[1] that once a query is raised during the assessment proceedings and the assessee has replied to it, it follows that the query raised was a subject of consideration of the A.O. while completing the assessment and it is not necessary that an assessment order should contain reference and/or discussion to disclose its satisfaction in respect of the query raised.

1 [2014] 44 taxmann.com 304 (Bombay)

11. It will also be apposite to reproduce Paragraph No. 8 of the judgment of this court in ***Commissioner of Income Tax vs. Fine Jewellery (India) Ltd.***[2] and it reads as under :

> *8. We find that the impugned order of the Tribunal does record the fact that specific queries were made during the assessment proceedings with regard to details of expenditure claimed under the head "miscellaneous expenses" aggregating to Rs.2.94 crores. The respondent-assessee had responded to the same and on consideration of response of the respondent-assessee, the Assessing Officer held that of an amount of Rs.17.98 lakhs incurred on account of repairs and maintenance out of Rs.2.94 crores is capital expenditure. This itself would be indication of application of mind by the Assessing Officer while passing the impugned order. The fact that the assessment order itself does not contain any discussion with regard to the balance amount of expenditure of Rs.1.76 crores, i.e., Rs.2.94 crores less Rs.17.98 lakhs claimed as revenue expenditure would not by itself indicate non-application of mind to this issue by the Assessing Officer in view of specific queries made during the assessment proceedings and the respondent-assessee's response to it. In fact this Court in the case of "Idea Cellular Ltd. Vs. Deputy CIT [2008] 301 ITR 407 (Bom) has held that if a query is raised during the assessment proceedings and responded to by the assessee, the mere fact that it is not dealt with in the Assessment Order would not lead to a conclusion that no mind had been applied to it.*
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> *Moreover, from the nature of expenditure as explained by the petitioner to the Assessing Officer during the assessment proceedings itself indicates that the view that the same were in the realm of revenue expenditure, is a possible view. Therefore, we find no fault in the impugned order having followed the binding decision of the Supreme Court in the case of Max India Ltd. (supra), while allowing the appeal before it.*
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> *Accordingly, no substantial question of law arise for consideration. Thus, appeal is dismissed. No order as to costs.*

12. Accordingly, no substantial question of law arise for consideration. Thus, appeal dismissed. No order as to costs.

(NEELA GOKHALE, J.) **(K.R. SHRIRAM, J.)**

2 [2015] 372 ITR 303 (Bom)