IN THE HIGH COURT OF JUDICATURE AT MADRAS

Dated: 30.09.2024

CORAM

THE HONOURABLE **DR. JUSTICE ANITA SUMANTH**
and
THE HONOURABLE **MR. JUSTICE G.ARUL MURUGAN**

T.C.A.No.1114 of 2010

Commissioner of Income Tax
Chennai. .... Appellant

Vs

Y.Jagan Mohan ... Respondent

PRAYER : APPEAL filed under Section 260 A of the Income Tax Act, 1961 against order dated 26.03.2010 passed in I.T.A.No.199/mds/09 for the Assessment Year 2004-05 on the file of the Income Tax Appellate Tribunal Madras 'A' Bench, Chennai.

For Petitioner : Ms.V.Pushpa
Senior Standing Counsel
For Respondent : Mr.R.Sivaraman

J U D G M EN T

(Judgment of the Court was delivered by Dr.ANITA SUMANTH,J.)

The Commissioner of Income Tax has filed the present Tax Case (Appeal) challenging the order of the Income Tax Appellate Tribunal (in short 'ITAT'/'Tribunal') relating to the assessment year (AY) 2004-05 confirming order dated 27.01.2009 passed under Section 263 of the Income Tax Act, 1961 (in short 'Act') revising the order of assessment dated 29.12.2006 passed under Section 143(3) of the Act.

2. The respondent/assessee had filed a return of income within the time provided under the Statute. After an intimation was issued under Section 143(1), the return was selected for scrutiny and notices under Sections 143(2) and 142(1) had followed. An order of assessment had been passed on 29.12.2006 after hearing the authorised representative of the assessee. Though brief, the assessing authority notes inter alia the claim of the assessee of short term capital loss and the verification carried out in that regard, that culminated in a minor addition.

3. The assessment order also contains a note making reference to an agreement between the seller and the purchaser that the seller/its affiliates

shall not indulge in certain activities without the express prior written approval of the purchaser. The assessing authority states that subject to approval being granted by his superiors, the assessment for previous assessment year i.e., A.Y.2003-04 will be reopened for consideration of certain additions.

4. On perusal of the assessment records, the Commissioner of Income Tax (CIT) was of the view that the assessment was erroneous and prejudicial to the interests of the revenue and hence issued a show cause notice dated 24.09.2008 invoking the provisions of Section 263 of the Act. The proposal contained in the show cause notice dated 24.09.2008 for revision of assessment was based on the following aspects:

1. *The agreed rental income of Rs.75,000/- was omitted to be assessed.*
2. *The claim of Rs.45 lakhs as consultancy charges paid to M/s Earnst and Young against the capital gains shown at Rs.12.50 Crores, is not allowable as the expenses are not wholly and exclusively incurred in connection with transfer.*
3. *Deduction u/s 54 EC being alleged investments in NABARD and REC Bonds by the assessee for Rs.7 Crores is not allowable as the investments are before the date of transfer.*

5. The assessee filed a detailed reply on 14.10.2008 pointing out that there was no error committed by the assessing authority in passing of order

dated 29.12.2006 and as such, the proposals contained the notice, particularly points 1 and 2, as exacted above, would not stand the scrutiny of the test under Section 263 of the Act.

6. On the third issue relating to exemption under Section 54EC of the Act, the assessee explained that the claim was on the basis that the investments had been made subsequent to the date of transfer and the assessing authority had examined the claim in detail at the time of assessment. The assessee hence sought clarity on the date of transfer per the assessment records in order that it may furnish additional submissions.

7. A clarification appears to have been furnished by the CIT on 10.11.2008 to the effect that the date of completion of transfer as per the departmental records was 16.12.2003. Based on the same, the assessee furnished additional submissions on 19.11.2008. The explanation tendered was that the agreement to sell the business of Mova Consultants Private Limited (Company) and all related assets had been entered into on 02.01.2003 (sale agreement) with Orchid Chemicals and Pharmaceuticals Limited.

8. The vendors were the company, the assessee, who was a Director in that company and Sali Health Care Private Limited. The sale agreement

provides for 120 days for completion of all transfer related formalities and hence the parties covenanted that the transfer would be completed on 30.04.2003. They were unable to complete the transfer as agreed upon and the date was extended to 16.12.2003 on which date the transfer was completed in full.

9. In the meanwhile, since the transfer qua the parties has been finalised as early as on 02.01.2003, the assessee invested the advances received, in the bonds issued by NABARD and REC. He had been advised that such investment was supported by a Circular of the CBDT No.359 dated 10.05.1983 and the decisions of the ITAT. Overriding the explanations tendered, the CIT passed an order dated 27.01.2009, adverse to the respondent.

10. He proceeded on the basis that the investments in bonds had been made prior to the date of transfer and since the source of investments was from redemption of certain securities and not the advances received in connection with transfer, it was not entitled to exemption under Section 54EC. He distinguished the Circular that had been relied upon stating that that Circular had been issued in the context of Section 54E and not Section 54EC.

11. In addition, he stated that even assuming that the said Circular was applicable the fact remained that the investment had been made out of redemption of certain other securities and not out of the earnest money or advances in relation to the transfer. The Commissioner was thus of the view that the assessee had not established a nexus between the amounts invested in the bonds and the advances, particularly since the balance in the bank account immediately preceding the credit of the redemption from securities was only Rs.1,94,801/-. A direction was thus given to withdraw the deduction that had been granted under Section 54EC and enhancing the assessment to that extent.

12.The assessee as well as Nova Consultants, which had suffered a similar order, challenged the order of the Commissioner of Income Tax before the Income Tax Appellate Tribunal ('Tribunal'/'ITAT'). The Tribunal noticed that the assessee was the Managing Director of one Mano Pharmaceuticals now known as Nova Consulting Private Limited and held a substantial interest in Sali Health Care as its Proprietor.

13.After a detailed consideration of the matter, the Tribunal confirmed the position that the assessing officer had failed to apply his mind to the assessment in regard to the first two issues i.e. the rental income and the consultancy charges paid to Ernst and Young confirmed the order of the CIT to that extent. As regards the deduction under Section 54EC, the Tribunal allowed the same.

14.Mrs.V.Pushpa, learned Senior Standing Counsel appearing for the Revenue assails the order of the Tribunal, pointing out that the order of the Tribunal is non-speaking and contains no discussion whatsoever as to the basis on which the appeal has been allowed. She is right in this. In fact, the order of the Tribunal, apart from being non-speaking, has not even noticed, or adverted to the primary facts in coming to the conclusion that the assessee's appeal must be partly allowed.

15.However, the year under consideration is 2004-05 and this tax case (appeal) is of the year 2010. We are hence not inclined to send the matter back to the Tribunal bearing in mind the elapse of time. On merits she submits that the investment in bonds was even prior to the date of transfer and hence the claim of the respondent for exemption was contrary to the Act. Learned Standing Counsel has cited the following decisions in support of her submissions:

1.R.Krishnaswamy v. Commissioner of Income-tax, Co. Circle, Chennai[1]
2.Bhupendra Kumar Bhaumik v. Union of India[2]

16.Mr.R.Sivaraman, learned counsel appearing for the respondent defends the order of the Tribunal, citing the following decisions:

1.Commissioner of Income-tax-II, Pune v. Subhash Vinayak Supnekar[3]
2.Mrs.Parveen P.Bharucha v. Deputy Commissioner of Income-tax, Circle 2, Pune[4]
3.Commissioner of Income-tax v. Sunbeam Auto Ltd.[5]
4.Commissioner of Income-tax v. Future Corporate Resources Ltd.[6]
5.Virtusa Consulting Services (P.) Ltd. v. Deputy Commissioner of Income Tax, Chennai[7]
6.Malabar Industrial Co. Ltd. v. Commissioner of Income-tax[8]
7.Jeevan Investment & Finance (P.) Ltd. v. Commissioner of Income Tax, City-1, Mumbai[9]

17.We have heard the rival contentions and had perused the case records. The assessee had circulated a copy of the agreement of sale which is part of the record and which is the subject matter of interpretation by the authorities. The relevant clauses are as follows:

> *1.6 'Completion' shall mean the completion of the sale and purchase in accordance with Clause 5 of this Agreement.*
> *1.7 'Completion Date' shall mean the date on which the*

1 [(2014) 43 taxmann.com 177 (Madras)]
2 [(2002) 125 Taxman 886 (Delhi)]
3 [(2017) 77 taxmann.com 226 (Bombay)]
4 [(2012) 28 taxmann.com 274 (Bom.)]
5 [(2010) 189 Taxman 436 (Delhi)]
6 [(2021) 132 taxmann.com 173 (Bombay)]
7 [(2021) 128 taxmann.com 22 (Madras)]
8 [(2000) 109 Taxman 66 (SC)]
9 [(2017) 88 taxmann.com 552 (Bombay)]

Completion occurs, as specified in Clause 4.3(b) of this Agreement, provided that such date shall be no later than 120 (one hundred twenty) days from the date of execution of this Agreement unless further extended by the mutual consent of the Parties in writing."
1.18 'Escrow Agreement' shall mean the Escrow Agreement to be executed by and between the Parties and the Escrow Agent at Chennai within 7 (seven) business days from the Date of the Agreement in the form and manner set out and annexed hereto as Schedule

18.Along with the agreement, the schedule of payments has also been produced which is extracted below:

Schedule – L
Schedule for Payment of Purchase Price

						Rs in Crores
Item	***Principal Conditions Precedent to be fulfilled***	***Mode of Payment***	***Amount Payable to Seller No.1***	***Amount Payable to Seller No.2***	***Amount Payable to Seller No.3***	***Total Amount Payable to Seller No.1, No.2 and No.3***
Agreement to Sell	*Execution of the Agreement to Sell and in addition, fulfillment of Conditions Precedent 4.2(a) and 4.2(e)*	*Payment to Sellers*	*10.00*	*0.50*	*3.50*	*14.00*
IPRs	*Ensuring that applications for all IPRs required for Business are in order and duly filed with appropriate authorities and signing of deeds of assignment for transfer of all brands / trade marks and other IPRs and their filing with the Register of Trademarks and Merchandise and obtaining due and proper acknowledgment of the Registrar of such filings. More specifically, the following Conditions Precedent : 4.2(k), and 4.2(n)*	*Payment to Sellers*			*3.50*	*3.50*

Drug Licenses, Third Party Drug Licenses and Other Product Licences	*i) Renewal and transfer of all the Drug Licences of the Sellers to the Purchaser. ii) Renewal of Third Party Drug Licences and Other Product Licences and continued operation of third party and other manufacturing arrangements for the purchaser. iii) Entering into of third party manufacturing agreements by the Third Party Manufacturers with the Purchaser. More specifically, fulfillment the following Conditions Precedent : 4.2(d), 4.2(e), 4.2(f), 4.2(g), 4.2(h), 4.2(i), 4.2(j), 4.2(m)*	*Payment to be made to the Sellers on the fulfillment of Principal Conditions Precedent to the sole satisfaction of the Purchaser.*	*0.25*	*0.25*	*3.00*	*3.50*
Final Payment	*Fulfillment of all the Conditions Precedent and fulfillment of all Further Obligations*	*Payment to be made to Escrow Account with the Escrow Agent and released to the Sellers on the fulfillment of all the Conditions Precedent and Further Obligations to the sole satisfaction of the Purchaser and released to Sellers upon the expiry of 9 months*			*3.00*	*3.00*

		from the date of the Agreement to Sell.				
		Total	***10.25***	***0.75***	***13.00***	***24.00***

19.This schedule reveals clearly that the date of receipt of advances is contemporaneous with the execution of the sale agreement that is dated 02.01.2003. The investments have been made only thereafter and hence it is clear that the source for the investments are the advances received from the purchasers. The respondent has also explained that the advances were initially deposited in mutual funds and the maturity amounts had been credited to its bank account from out of which the investment in bonds had been made.

20. The mere fact that the advances had been deposited in mutual funds would not, in our view, militate against the claim under Section 54EC as the investments in bonds had been made from out of the proceeds of the mutual funds. There is no dispute, rather it is admitted, that there were no other funds available with the assessee from out of which the investment in bonds could have been made. The nexus between the advances and the amounts invested in bonds is clear, directly traceable to the advances received.

21.In light of this admitted position, we return a finding based on the materials available on record that the source of the investment in bonds are the advances that has been received by the assessee in relation to the subject transaction. In fact, this aspect of the matter has not been lost sight of by the assessing authority. Under notice dated 01.12.2006, the assessee has been called upon to furnish various details prior to finalisation of assessments. The notice reads thus:

> *In the statement of income filed along with the Return of Income for the A.Y.2004-05 from Long Term Capital Gains (LTCG) from sale of brands of Rs.12,50,00,000/-, you have claimed exemption u/s 54EC of the following:-*
> *1) Investments in NABARD Bonds - Rs.5 crores*
> *2) Investments in REC Bonds - Rs.2 crores to arrive at a total of 7 crores and LTCG at Rs.5,50,00,000/-. While doing so, you have deducted expenses incurred for sale of Rs.45 lakhs.*
> *Kindly furnish evidence for having received proceeds towards sale of brands at Rs.12,50,00,000/- and expenses for Rs.45 lakhs. You are requested to furnish the names and addresses of the persons to whom the brands were sold and evidences for expenses to the extent of Rs.45 lakhs."*
> *"In the balance sheet as on 31-3-04 under the head Loans and others. It has been mentioned as follows:*
> *In the P&L Account, you have shown a receipt of Rs.50 lakhs as non compete fee. Kindly furnish evidence together with name and address of the person from whom you have received this money.*
> *You have received interest from REC Bonds of Rs.4,51,506/-. Please produce evidence.*
> *Interest of Rs.2,93,441.40 has been received from Banks on FD. Please furnish evidence.*

You have shown in the Profit and Loss account, sale of bonds to IPR to the extent of Rs.12.50 crores. Kindly furnish evidence for this and name and address of the person from whom you have received this money. To prove this, you are requested to produce bank statement for having received this sum.
Please furnish a copy of agreement entered into with M/s Orchid Chemicals & Pharmaceuticals Ltd."

22.A perusal of the above notice informs us that the claim of capital gains has not escaped the attention of the assessing officer. Necessary documents including the agreement have been called for and an explanation has been sought from the assessee that has been duly tendered.

23.The next argument of the revenue is that Section 54EC requires the investments to be made only subsequent to the date of transfer. In this regard, the respondent has relied upon a Circular issued in the context of Section 54E. The Circular reads thus:

CIRCULAR : NO. 359 [F.NO. 207/8/82-IT(A-II)]

SECTION 54F OF THE INCOME-TAX ACT, 1961 - CAPITAL GAINS - EXEMPTION OF, IN CASE OF INVESTMENT IN RESIDENTIAL HOUSE - ASSESSEE INVESTING EARNEST MONEY IN SPECIFIED ASSETS BEFORE DATE OF TRANSFER - WHETHER AMOUNT SO INVESTED QUALIFIES FOR EXEMPTION

CIRCULAR : NO. 359 [F.NO. 207/8/82-IT(A-II)], DATED 10-5-1983

1.*Section 54E provides for exemption of long-term capital* *gains if the net consideration is invested by the assessee in specified assets within a period of six months after the date of such transfer. A technical interpretation of section 54E could mean that the exemption from tax on capital gains would not be available if part of the consideration is invested prior to the date of execution of the sale deed as the investment cannot be regarded as having been made within a period of six months after the date of transfer.*

2.*On consideration of the matter in consultation with the Ministry of Law, it is felt that the foregoing interpretation would go against the purpose and spirit of the section. As the section contemplates investment of the net consideration in specified assets for a minimum period and as earnest money or advance is a part of the sale consideration, the Board have decided that if the assessee invests the earnest money or the advance received in specified assets before the date of transfer of asset, the amount so invested will qualify for exemption under section 54E.*

24.The revenue argues that the Circular is inapplicable as it has been rendered in reference to Section 54E and not 54EC. Hence, the provisions of Section 54E and Section 54EC are extracted below:

54E. Capital gain on transfer of capital not to be assets charged in certain cases.—(1) Where the capital gain arises from the transfer of a long-term capital asset before the 1st day of April, 1992], the capital asset so transferred being hereafter in this section referred to as the original asset and the assessee has, within a period of six months after the date of such transfer, invested or deposited the whole or any part of the net consideration] in any specified asset such specified asset being hereafter in this section referred to as the new asset, the capital gain shall be dealt with in accordance with the following provisions of this section, that is to say,— (a) if *the cost of the new asset is not less than the net consideration in respect of the original asset, the whole of such capital gain shall not be charged under section 45; (b) if the cost of the new asset is less than the net consideration in respect of the original asset, so much of the capital gain as bears to the whole of the capital gain the same proportion as the cost of acquisition of the new asset bears to the net consideration shall not be charged under section 45:*

54EC. Capital gain not to be charged on investment in certain bonds.—(1) Where the capital gain arises from the transfer of a long-term capital asset, being land or building or both, the capital asset so transferred being hereafter in this section referred to as the original asset and the assessee has, at any time within a period of six months after the date of such transfer, invested the whole or any part of capital gains in the long-term specified asset, the capital gain shall be dealt with in accordance with the following provisions of this section, that is to say,— (a) if the cost of the long-term specified asset is not less than the capital gain arising from the transfer of the original asset, the whole of such capital gain shall not be charged under section 45;

25.Section 54 and the provisions thereafter, from Section 54A to Section 54 GB, provide for an exemption from the levy of capital gains in various stipulated circumstances. Section 54E states that the capital gain arising on the transfer of a capital asset prior to 01.04.1992, is not to be charged in certain cases. Similarly, Section EA and EB, applicable in the event of the transfer of a long-term capital asset before 01.04.2000, grants an exempts from capital gain if the gain is invested in specified securities in the manner provided under those sections.

26.The exemption granted under Section 54EA and EB in respect of transfers prior to 01.04.2000, has been continued by Section 54EC, and is applicable to transfers post 01.04.2000. The scheme of capital gains exemption is thus seen to have envisaged a seamless sequence, from Section E dealing with transfers prior to 01.04.1992 to the present-day Section EC applicable to transfers post 01.04.2000, without interruption. There are, by and large, no major differences in the ingredients of the scheme itself. Hence, in our considered view, there should be no differences in the interpretation of those provisions, barring those areas where the provision itself makes a patent distinction.

27.The Circular issued in the context of Section 54E is thus applicable in the context of Section 54EC as well as the scheme of exemption under erstwhile Section 54E continues in 54EC in one continuous progression.

28.The Bombay High Court in *Commissioner of Income-tax-II, Pune v. Subhash Vinayak Supnekar*[10] considered the substantial question of whether an assessee was entitled to deduction under Section 54EC of the Act when that assessee had not fulfilled the mandatory requirement of making the investment within six months from the date of transfer.

10 (2017) 77 taxmann.com 226 (Bombay)

29.In that case, the agreement to sale of a property was dated 21.02.2006 and the final sale took place on 05.04.2007. That assessee had invested Rs.50,00,000/- from out of the advance received under the sale agreement in REC bonds. The investment had been made on 02.02.2007. The department rejected the claim for capital gains exemption on the ground that the investment had been made anterior to the date of sale deed.

30.The High Court however reversed those orders applying the ratio in *Mrs.Parveen P.Bharucha v. Deputy Commissioner of Income-tax, Circle 2, Pune*[11] and CBDT Circular No.359 dated 10.05.1983. The assessee in that case had relied on a decision of its co-ordinate bench in the case of *Vhikulal Chandak Hus v. ITO* and the appeal of the revenue against that decision had been dismissed by the Nagpur Bench by the Bombay High Court in Income Tax Appeal No.68 of 2009 by an order dated 22.08.2010.

31.Mrs.Pushpa has relied on a decision of this Court in R.Krishnaswamy's case. We find that the facts of that case are distinguishable when compared with the present. The substantial questions of law in that case were as follows:

> "*1. Whether in the facts and circumstance of the case, the Appellate Tribunal was right in coming to the conclusion*

11 348 ITR 325

that even though the vacant possession of the property was handed over only on 25.03.2004 the capital gains will arise for the assessment year 2003-2004 and not for the assessment year 2004-2005?

2. Whether in the facts and circumstances of the case the Appellate Tribunal was right in coming to the conclusion that the part of the sale consideration was received on 21.12.2002 hence the capital gains will arise only for the assessment year 2003-2004 and not for the assessment year 2004-05?

3. Whether in the facts and circumstances of the case the Appellate Tribunal was right in coming to the conclusion that the sale consideration was received on 21.12.2002 and the property was handed over on the same day even though the possession of the property was handed over only on 25.03.2004?"

32.R.Krishnaswamy had entered into a sale agreement on 07.12.1999 and had received advance from the company. The remaining consideration had been received on 21.12.2002 and the sale deeds had been registered on various dates till 23.03.2004. Possession had been handed over to the agreement holders on 25.03.2004 and construction had been completed in October 2005. Completion certificate had been given by the CMDA on 12.06.2006.

33.R.Krishnaswamy claimed deduction under Section 54EC of the Act on the basis that the entire sale consideration had been invested in prescribed bonds. The issue had arose in that case was the year in which the claim would be admissible, whether 2003-04 or 2004-05 as the transactions had straddled the financial years in relation to both the aforesaid years.

34.That was the substantial issue to be decided by the Court in deciding which the Court has referred to Section 53A of the Transfer of Property Act in relation to part performance, ultimately bifurcating the claim of capital gains and apportioning the same towards two separate years. This case does not come to the aid of the revenue as the issue that was decided by the Bench in R.Krishnaswamy's case was different and the facts are also entirely distinguishable. The Delhi High Court has, however, in the case of *Bhupendra Kumar Bhaumik v. Union of India*[12] considered a similar case albeit in the context of Section 54E, holding in favour of the assessee.

35. The ratio of the judgment of the Supreme Court in the case of *Malabar Industrial Co. Ltd.* (supra) would also fully support us in our conclusion that there is no error in the order of the assessing officer warranting intervention under Section 263 of the Act.

36. In light of the detailed discussion above, the substantial questions of law are answered in favour of the respondent-assessee and against the department. The Tax case (appeals) are dismissed.

12 259 ITR 58

(A.S.M.,J) (G.A.M.,J)
30.09.2024

Index:Yes
Speaking order
Neutral Citation: Yes
sl/vs

To

The Income Tax Appellate Tribunal,
Madras 'A' Bench, Chennai.

DR. ANITA SUMANTH,J.
and
MR. G.ARUL MURUGAN,J.

sl/vs

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