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IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION
WRIT PETITION NO.788 OF 2001

M/s. J. S. & M. F. Builders ... Petitioner
Vs.
A. K. Chauhan and others ... Respondents

Mr. Percy Pardiwalla, Senior Advocate a/w. Mr. Balasaheb Yewale and Ms Rupali Vasaikar i/b. Rajesh Shah & Co. for Petitioner.

CORAM : UJJAL BHUYAN &
MILIND N. JADHAV, JJ.

Reserved on : FEBRUARY 27, 2020
Pronounced on : JUNE 12, 2020

JUDGEMENT:

1. By filing this petition under Article 226 of the Constitution of India, petitioner has assailed the legality and validity of the four impugned notices, all dated 25.02.2000, issued under Section 148 of the Income Tax Act, 1961 (briefly 'the Act' hereinafter) proposing to re-assess the income of the petitioner for the assessment years 1992-93, 1993-94, 1994-95 and 1995-96 on the ground that income chargeable to tax for the said assessment years had escaped assessment within the meaning of Section 147 of the Act.

2. In other words, subject matter of the present writ petition relates to challenge to the notices proposing to re-open the assessments for the aforesaid four assessment years.

3. We have heard Mr. Percy Pardiwalla, learned senior counsel along with Mr. Balasaheb Yewale and Ms Rupali Vasaikar, learned counsel for the petitioner. However none has appeared for the respondents.

4. Case of the petitioner is that it is a partnership firm constituted by a deed of

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partnership dated 21.10.1977. Object of the petitioner is to carry out the business of builders and developers. At the time of filing the writ petition the partnership consisted of eight partners. Petitioner is an assessee under the Act, Respondent No.1 being the jurisdictional Assessing Officer and respondent No.2 being the superior higher authority having jurisdiction over respondent No.1.

5. An agreement was entered into on 08.11.1977 between Mr. Krishnadas Kalyanji Dasani and the petitioner whereby and whereunder Mr. Dasani agreed to sell and the petitioner agreed to purchase a property situated at Tilak Road, Borivali admeasuring approximately 6,173.20 square metres. The property consisted of seven structures and two garages. The property was mortgaged and all the tenaments were let out. Aggregate consideration for the purchase was Rs.3,00,000.00 and a further expenditure of Rs.44,087.00 was incurred by way of stamp duty and registration charges. The said property was purchased subject to all encumbrances. The purchased property was reflected in the balance sheets of the petitioner drawn up thereafter as a fixed asset.

6. For almost a decade after purchase, petitioner entered into various agreements with the tenants to get the property vacated. In this process petitioner incurred a further sum of Rs.9,92,427.00.

7. In the balance sheet as on 30.09.1987 the Borivali property was shown as a fixed asset, value of which was disclosed at Rs.13,36,514.00, the detailed break up of which has been furnished at page 35 of the paper book.

8. With effect from 01.10.1987, petitioner converted a portion of the property into stock-in-trade and continued to retain that part of the property which still remained tenanted as a fixed asset. The market value of the entire Borivali property as on 01.10.1987 was arrived at Rs.69,38,000.00 out of which the value of the property that was converted into stock-in-trade was determined at

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Rs.66,29,365.00.

9. Petitioner thereafter demolished the vacant structures and commenced construction of a multi-storied structure.

10. In the balance sheet as on 31.03.1989, petitioner reflected the tenanted property as a fixed asset at a cost of Rs.2,86,740.00 and the stock-in-trade at a value of Rs.66,29,365.00. It is stated that a revaluation reserve of Rs.55,58,759.00 was also credited. In the note accompanying the computation of income it was clearly mentioned that a conversion of a part of the Borivali property was made into stock-in-trade and the liability to tax under Section 45(2) of the Act would arise as and when the flats were sold.

11. During the previous year relevant to the assessment year 1992-93, petitioner had entered into fourteen agreements for sale of fourteen flats, total area of which admeasured 10,960 square feet.

12. For the assessment year 1992-93 petitioner filed return of income on 02.11.1992 declaring a total income of Rs.17,55,760.00. Petitioner declared income chargeable under the head 'profits and gains of business or profession' at Rs.9,37,385.00 and the income chargeable under the head 'capital gains' at Rs.8,10,993.00. The 'capital gains' was arrived at by determining the difference between the market value of the land converted into stock-in-trade as on 01.10.1987 and the cost incurred by the petitioner which came to a figure of Rs.55,87,591.00. Having regard to the total built up area of 37,411 square feet, the 'capital gains' per square feet was computed at Rs.149.36 on a pro-rata basis. Accordingly, having regard to the area of 10,960 square feet sold, the 'capital gains' was determined at Rs.16,36,986.00. Along with the return of income, a computation of income as well as an audit report in terms of Section 44AB of the Act were filed.

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12.1. During the assessment proceedings, petitioner's representative had filed a detailed letter explaining the nature of the activity that was carried out as well as the method of computation of income.

12.2. Respondent No.1 thereafter completed the assessment for the said assessment year and passed assessment order dated 26.04.1993 under Section 143(3) of the Act assessing the petitioner at the income of Rs.17,85,560.00.

13. Petitioner filed return of income for the assessment year 1993-94 on 29.10.1993 declaring total income of Rs.17,00,233.00. Like the previous assessment year, income was computed both under the head 'profits and gains of business or profession' as well as under the head 'capital gains' for twelve flats sold during the relevant previous year. The return was accompanied by the tax audit report as well as the profit and loss account and balance sheet.

13.1. In the course of the assessment proceedings for the said assessment year, petitioner furnished all the relevant details including the nature of the activities undertaken, details of the flats sold and the closing stock.

13.2. Respondent No.1 completed the assessment for the said assessment year and passed the assessment order on 18.10.1994 under Section 143(3) of the Act assessing the petitioner at an income of Rs.17,30,230.00. It is stated that in the assessment order the Assessing Officer specifically noted that income from 'long term capital gain' was declared in terms of Section 45(2) of the Act.

14. Petitioner filed its return of income for the assessment year 1994-95 on 31.10.1994. In the return, total income was shown at Rs.10,09,674.00. In this connection intimation under Section 143(1)(a) of the Act was issued on 30.03.1995.

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15. For the assessment year 1995-96, petitioner filed its return of income on 27.10.1995. In the return petitioner declared income under both heads i.e. 'income from business' and 'capital gains'. Income of the petitioner was computed in a similar manner as in earlier years with similar disclosures in the tax audit report, profit and loss account and balance sheet furnished along with the return. In the course of the assessment proceedings, petitioners furnished details of flats sold as well as the manner of computing profit in terms of Section 45(2) of the Act. Be that as it may, petitioner's assessment for the assessment year 1995-96 was completed and thereafter assessment order was passed on 15.05.1996 under Section 143(3) of the Act determining the taxable income at Rs.1,32,930.00.

16. According to the petitioner, it received on 08.03.2000 four notices, all dated 25.02.2000, issued under Section 148 of the Act for the four assessment years i.e. assessment years 1992-93 to 1995-96 proposing to re-assess the petitioner for the said assessment years. It was mentioned in the notices that respondent No.1 had reason to believe that income of the petitioner chargeable to tax for the said assessment years had escaped assessment within the meaning of Section 147 of the Act. Therefore the notices were issued after obtaining necessary satisfaction of respondent No.2. Respondent No.1 stated that he proposed to re-assess the income of the petitioner for each of the four assessment years and therefore it was called upon to submit returns of income in the prescribed format for each of the assessment years.

17. Petitioner through its chartered accountant wrote to respondent No.1 on 31.03.2000 requesting the latter to furnish the reasons for reopening the assessment.

18. It may be mentioned that in response to the notices dated 25.02.2000 petitioner filed its returns of income for the aforesaid four assessment years on 07.04.2000 contending that filing of the returns was without prejudice to its

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contention that the impugned notices were without jurisdiction. In the subsequent returns, the details of income remained the same as in the original returns. Additionally the chartered accountant once again requested respondent No.1 to furnish a copy of the reasons recorded for re-opening the assessments.

19. Ultimately vide separate letters dated 17.10.2000 respondent No.1 furnished the reasons recorded on the basis of which re-assessment proceedings were initiated. The reasons recorded for each of the assessment years were identical save and except the assessment details and figures. Though the reasons recorded would be dealt in detail in the later part of the judgment, suffice it to say that respondent No.1 broadly gave four reasons to justify initiation of re-assessment proceedings. Firstly, petitioner was not justified in assuming that the market value of the stock adopted as on 01.10.1987 would continue to remain static in the subsequent years. In other words, the closing stock of the land should have been valued at the market price as on the date of closing of accounts for the year concerned. This resulted in under valuation of closing stock and consequent reduction of profit. Secondly, even though petitioner might have entered into agreements to sell certain flats and sold the flats, the ownership of the land continued to remain with the petitioner. The whole of the land under the ownership of the petitioner constituted its stock-in-trade and it should have been valued at the market price as on the date of closing of accounts for the year concerned. Thus, assessee had suppressed the market price of the closing stock thereby reducing the profit. Thirdly, for the purpose of computing the 'capital gains' in terms of Section 45(2) of the Act, petitioner was not justified in taking the cost of the entire land; rather, petitioner ought to have taken only a fraction of the original cost of Rs.3,00,000.00. Thus, there was inflation of cost. Lastly, in terms of Section 45(2), the 'capital gains' arising on conversion of the land into stock-in-trade ought to have been assessed only in the year in which the land was sold or otherwise transferred. As the land was not conveyed to the co-operative society, petitioner was not justified in offering to tax the 'capital gains' in terms of Section

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45(2) of the Act on the basis of the flats sold during each of the previous years relevant to the four assessment years under consideration.

20. Aggrieved by the issuance of the impugned notices under Section 148 of the Act, petitioner has preferred the present writ petition seeking the reliefs as indicated above.

21. This Court by order dated 31.01.2002 had admitted the writ petition for final hearing and passed an interim order to the effect that assessment should be subject to result of the writ petition and that respondents should not raise any demand pursuant to the re-assessment during pendency of the writ petition.

22. Thereafter respondent No.1 filed affidavit in reply through Shri Pramod Kumar, the then Joint Commissioner of Income Tax, Special Range-9, Mumbai. It is stated that his predecessor in office after recording reasons and after obtaining sanction from the Commissioner of Income Tax issued notices dated 25.02.2000 under Section 148 of the Act for the assessment years 1992-93 to 1995-96 thereby re-opening the assessments on the ground that income of the petitioner chargeable to tax had escaped assessment for those assessment years. It is further stated that the notices dated 25.02.2000 were served on the petitioner on 08.03.2000. In pursuance to the notices, petitioner filed returns of income disclosing the same income as already declared in the original returns. Reasons recorded by the Assessing Officer prior to issuance of the notices under Section 148 of the Act and sanction accorded by the Commissioner of Income Tax have been annexed to the affidavit. Referring to the statutory remedies available, it is contended that no prejudice has been caused to the petitioner by issuance of the impugned notices. Therefore, the writ petition should be dismissed.

23. Referring to Sections 147 and 148 of the Act, Mr. Pardiwalla, learned senior counsel for the petitioner submits that to assume jurisdiction under Section 147 of

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the Act, the Assessing Officer must have reason to believe that any income chargeable to tax has escaped assessment for the assessment year under consideration. Placing reliance on the decision of the Supreme Court in *Income Tax Officer Vs. Lakhmani Mewal Das*, **103 ITR 437**, he submits that where an assessment under Section 143(3) of the Act is sought to be re-opened after the expiry of four years from the end of the relevant assessment year, two conditions would have to be satisfied before an Assessing Officer acquires jurisdiction to issue notice under Section 148 of the Act - firstly, he must have reason to believe that income chargeable to tax has escaped assessment and secondly, he must have reason to believe such income has escaped assessment by reason of the failure on the part of the assessee to make a return under Section 139 or not responding to statutory notices under Section 142 or Section 148 or to disclose fully and truly all material facts necessary for his assessment for that assessment year. Duty of the assessee does not extend to beyond making a true and full disclosure of primary facts. It is for the Assessing Officer to draw correct inference from the primary facts. Once an inference is drawn which may susbsequently appear to be erroneous, that would amount to mere change of opinion with regard to that inference and would not justify re-opening of assessment. The reasons for formation of the belief that income had escaped assessment must have a rational connection on the formation of the belief. In other words, there should be live link or close nexus between the materials before the Assessing Officer and the belief formed by him regarding escapement of income from assessment. He submits that the above jurisdictional facts are totally absent in the present case thereby vitiating the impugned notices. In this connection, he has also placed reliance on a decision of this Court in *Prashant S. Joshi Vs. ITO*, **324 ITR 154**.

23.1. Mr. Pardiwalla further submits that petitioner had fully complied with the requirement of Section 45(2) of the Act and the capital gains arising on the conversion of the land into stock-in-trade was offered and rightly assessed to tax in the years in which the flats were sold on the footing that on the sale of the flat

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there was also a proportionate sale of the land. This methodology adopted by the petitioner is in accordance with law. Adverting to the various figures pertaining to the market value of the stock-in-trade as well as the cost of acquisition of the property, he submits that respondent No.1 was not justified in taking the view that there was inflation in the cost and that income had escaped assessment. He also submits that it is not correct to think that any profit arises out of valuation of the closing stock. In this connection, he has placed reliance on a decision of the Supreme Court in *Chainrup Sampatram Vs. CIT*, **24 ITR 481**. He has also referred to a decision of this Court in *CIT Vs. Piroja C. Patel*, **242 ITR 582** to contend that the expenditure incurred for having the land vacated would certainly amount to cost of improvement which is an allowable expenditure. Finally he submits that all the reasons given by the Assessing Officer for re-opening assessments do not make out any case of re-opening as in the given facts, no prudent person can form a reasonable belief that income had escaped assessment. He therefore submits that the impugned notices may be set aside and the writ petition be allowed.

24. Submissions made by learned counsel for the petitioner have been duly considered. In the absence of any representation on behalf of the respondents, the affidavit filed on behalf of respondent No.1 along with the documents annexed thereto have been duly considered.

25. Section 147 of the Act deals with income escaping assessment. As per Section 147, if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may subject to the provisions of Sections 148 to 153 assess or re-assess such income and also such other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the re-assesement proceedings. As per first proviso, where an assessment under Section 143(3) or under Section 147 has been made for the relevant assessment year, no action shall be taken under Section 147 after the expiry of four years from the end of the relevant assessment

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year unless any income chargeable to tax has escaped assessment for such assessment year by reason of the failure on the part of the assessee to make a return under Section 139 or in response to a notice issued under Section 142(1) or Section 148 or to disclose fully and truly all material facts necessary for his assessment for that assessment year.

26. In **Prashant S. Joshi** *(supra),* this Court observed that the basic postulate which underlines Section 147 is formation of the belief by the Assesing Officer that any income chargeable to tax has escaped assessment for any assessment year. In other words, the Assessing Officer must have reason to believe that income chargeable to tax for a particular assessment year has escaped assessment for the relevant assessment year before he procceeds to issue notice under Section 148. The reasons which are recorded by the Assessing Officer for re-opening an assessment are the only reasons which can be considered when the formation of the belief is impugned. Recording of reasons distinguishes an objective from a subjective exercise of power and is a check against arbitrary exercise of power. The reasons which are recorded cannot be supplemented subsequently by affidavits. The question as to whether there was reason to believe within the meaning of Section 147 that income has escaped assessment must be determined with reference to the reasons recorded by the Assessing Officer. Even in a case where only an intimation is issued under Section 143(1), the touchstone to be applied is as to whether there was reason to believe that income had escaped asessment.

27. Earlier, Supreme Court in **Lakhmani Meval Das** *(supra)* when the contours of Section 147 was different though the essence of the section was the same explained the expression 'reason to believe'. The grounds or reasons which lead to the formation of belief that income chargeable to tax has escaped assessment must have a material bearing on the question of escapement of income from assessment. Once there exists reasonable grounds for the Income Tax Officer to form such

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belief, that would be sufficient to clothe him with jurisdiction. Sufficiency of the grounds, however, is not justiciable. The expression 'reason to believe' does not mean a purely subjective satisfaction on the part of the Income Tax Officer. The reason must be held in good faith and cannot be a mere pretence. It is open to a court to examine whether the reasons for the formation of the belief have a rational connection with or a relevant bearing on the formation of the belief and are not extraneous or irrelevant. Elaborating further, Supreme Court held that rational connection postulates that there must be a direct nexus or live link between the material coming to the notice of the Income Tax Officer and the formation of his belief that there has been escapement of income from assessment in that particular year. Sounding a note of caution, Supreme Court observed that the powers of the Income Tax Officer to re-open assessment though wide, are not plenary; the words of the statute are 'reason to believe' and not 'reason to suspect'.

28. Having noticed the above, we may now advert to the reasons given by the Assessing Officer for re-assessment. We take up the reasons given for the assessment year 1992-93 as the reasons given for the other assessment years are identical.

28.1. Firstly, Assessing Officer after recording the sequence of events from acquiring the property vide the deed of conveyance dated 23.04.1980 noted that assessee had converted part of the property into stock-in-trade on 01.10.1987 with a view to construct flats. On the date of conversion into stock-in-trade the value thereof was determined at Rs.66,29,365.00. Upto assessment year 1991-92 there was no construction. After the building was constructed, the constructed flats were sold to various customers. On sale of flats, assessee reduced proportionate market value of the land as on 31.03.1989, in the same ratio as the area of the flat sold bore to the total constructed area. However, assessee valued the closing stock at market price prevailing as on 01.10.1987. According to the Assessing Officer the closing stock should have been valued at market price on close of each accounting

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year. This resulted into under-valuation of closing stock and consequent reduction of profit.

28.2. Secondly, land as an asset is separate and distinct from the building. Building was shown as a work in progress in the profit and loss account prepared by the asessee and filed with the return. Even after construction of building and sale of flat, the stock i.e., the land was still under the ownership of the assessee. Ownership of land was not transferred. As the land continued under the ownership of the assessee, its value could not be reduced on the plea that flat was sold. The whole of the land under ownership of the assessee constituted its stock-in-trade and it should have been valued at the market price as on the date of closing of the accounts for the year under consideration. Therefore, the Assessing Officer alleged that the assessee had suppressed the market price of the closing stock, thus reducing the profit.

28.3. Third ground given was regarding computation of 'capital gains' furnished with the return of income. Assessing Officer noted that the total capital gains as on 01.10.1987 was arrived at by deducting the cost of the land as on 01.10.1987 i.e., Rs.10,41,774.00 from the fair market value of the land i.e., Rs.66,29,365.00 which came to Rs.55,87,591.00. According to the Assessing Officer, assessee made deduction of the cost incurred for the entire land whereas only a fraction of the said land was converted into stock-in-trade where construction was made. Assessing Offier worked out that cost of the converted piece of land was only Rs.13,260.00. This figure he arrived at by deducting Rs.2,86,740.00 which was the value of the tenanted property from the cost of the property i.e. Rs.3,00,000.00. Thus, he alleged that there was inflation of cost by Rs.10,28,514.00 (Rs.10,41,774.00 - Rs.13,260.00).

28.4. The last ground given by the Assessing Officer was regarding offering of long term capital gain by the assessee. Assessing Officer noted that for the purpose

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of computation of long term capital gain, assessee estimated the fair market value of the land converted to stock as on 01.10.1987 at Rs.66,29,365.00 which was reduced by the cost incurred as on 01.10.1987 i.e., Rs.10,74,774.00 (sic). However, Assessing Officer also noted that the method of computation of cost was not clear in view of the fact that the whole of the land with tenanted structures was purchased for Rs.3,00,000.00. Assessing Officer further noted the methodology adopted by the assessee for computation of long term capital gain. According to him, Assessee had worked out the difference between the fair market value of the land converted to stock and the cost and thereafter divided it by the total permissible built-up area. The quotient was identified by the assessee as capital gains per square feet. Assessee thereafter multiplied the built-up area of individual flats sold with such quotient and claimed it to be the 'capital gains' for the year under consideration. By adopting such computation assessee was claiming sale of land in different years in the same ratio as the area of flat sold bore to the total permissible FSI area. But this calculation was not accepted by the Assessing Officer primarily on the ground that land as a stock was different from the flats. Selling of the flats did not amount to selling of proportionate quantity of land. Under Section 45(2) of the Act, 'capital gains' for land should be considered in the year when land was sold or otherwise transferred by the assessee. Though flats were sold, ownership of the land continued to remain with the assessee. 'Capital gains' would be chargeable to tax only in the year when the land was sold or transferred to the co-operative society formed by the flat purchasers and not in the year when individual flats were sold.

29. Regarding ground Nos.1 and 2, contention of the petitioner is that respondent No.1 proceeded on the erroneous presumption that stock-in-trade had to be valued at the present market value. There is merit in the contention of the assessee if we analyse the decision of the Supreme Court in **Chainrup Sampatram** *(supra)*. In that case, Supreme Court held that it would be wrong to assume that the valuation of the closing stock at market rate has for its object the

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bringing into charge any appreciation in the value of such stock. The true purpose of crediting the value of unsold stock is to balance the cost of those goods entered on the other side of the account so that the cancelling out of the entries relating to the same stock from both sides of the account would leave only the transactions on which there had been actual sales in the course of the year showing the profit or loss actually realised on the year's trading. While anticipated loss is taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into the account as no prudent trader would care to show increased profit before its actual realisation. This is the theory underlying the rule that the closing stock has to be valued at cost or market price whichever is lower and it is now generally accepted as an established rule of commercial practice and accountancy. In such circumstances, taking the view that profits for income tax purposes are to be computed in conformity with the ordinary principles of commercial accounting unless such principles have been superseded or modified by legislative enactments, Supreme Court held that it would be a misconception to think that any profit arises out of valuation of the closing stock.

30. In so far the third ground is concerned i.e., computation of 'capital gains', stand of the assessee is that it had rightly deducted the cost incurred in acquiring the property from the fair market value of the land converted into stock-in-trade. The cost incurred included not only the sale price of the land i.e., Rs.3,00,000.00 but also expenditure incurred by way of stamp duty and registration charges amounting to Rs.44,087.00. That apart, assessee had incurred a further sum of Rs.9,92,427.00 in getting the entire property vacated. Contention of the Assessing Officer that there was inflation of cost is not correct.

30.1. At this stage we may refer to some of the legal provisions having a bearing on this ground as well as on the fourth ground.

30.2. Section 45 deals with 'capital gains'. As per sub-section (1), any profits or

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gains arising from the transfer of a capital asset affected in the previous year shall, save as otherwise provided in Sections 54 to 54H, be chargeable to income tax under the head 'capital gains' and shall be deemed to be the income of the assessee for the previous year in which the transfer took place. Thus, any profits or gains arising from the transfer of a capital asset shall be deemed to be the income of the assessee for the previous year in which the transfer took place and shall be chargeable to income tax under the head 'capital gains'. The two key expressions in this provision are 'transfer' and 'capital asset' but before we deliberate upon these two expressions, it would be useful to refer to sub-section (2) of Section 45 and Section 48.

30.3. Sub-section (2) of Section 45 starts with a *non-obstante* clause. It says that 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 is 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. Therefore, sub-section (2) which had overriding effect over sub-section (1) says that the profits or gains arising from the transfer of a capital asset by way of conversion by the owner into stock-in-trade of the business carried on by the owner shall be chargeable to income tax as his income of the previous year in which such stock-in-trade is sold or is otherwise transferred by him; further, 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 as a result of the transfer of the capital asset.

30.4. This brings us to Section 48 of the Act which deals with mode of computation of capital gains. The main provision of Section 48 says that the

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income chargeable under the head 'capital gains' shall be computed by deducting from the full value of the consideration received or accrued as a result of transfer of the capital asset the following amounts i.e.,-

(1) expenditure incurred wholly and exclusively in connection with such transfer;

(2) the cost of acquisition of the asset and the cost of any improvement thereto.

30.5. Thus, for computing the income under the head 'capital gains', the full value of consideration received as a result of transfer of the capital asset shall be deducted by the expenditure incurred in connection with such transfer, cost of acquisition of the asset and the cost incurred in improvement of the asset. The expression 'the full value of the consideration' would mean the fair market value of the asset on the date of such conversion. The meaning of the expressions 'cost of improvement' and 'cost of acquisition' are explained in Sections 55(1) and 55(2) of the Act respectively.

30.6. The expression 'capital asset' occuring in sub-section (1) of Section 45 is defined in sub-section (14) of Section 2. 'Capital asset' means property of any kind held by an assessee whether or not connected with his business or profession as well as any securities held by a foreign institutional investor but does not include any stock-in-trade, consumable stores or raw materials, personal effects, etc.

30.7. Again, the word 'transfer' occuring in sub-section (1) of Section 45 has been defined in Section 2(47) of the Act. As per this definition, 'transfer' in relation to a capital asset includes sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or compulsory acquisition of the asset or in case of conversion of the asset by the owner into stock-in-trade of the business carried on by him, such conversion or any transaction involving the allowing of possession of any immovable property to be taken or retained in part performance

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of a contract or any transaction whether by way of becoming a member of or acquiring shares in a co-operative society etc. which has the effect of transferring or enabling the enjoyment of any immovable property.

30.8. In the case of **Miss Piroja C. Patel** *(supra)*, the question before this Court was whether the Tribunal was justified in holding that the amount in question being compensation paid by the assessee to the hutment dwellers for vacating the land was an allowable expenditure within the meaning of Section 48 read with Section 55 of the Act. This Court held that on eviction of the hutment dwellers from the land in question, the value of the land increases and therefore, the expenditure incurred for having the land vacated would certainly amount to cost of improvement.

30.9. Thus in so far the third ground is concerned, we do not find any rationale in the view taken by the Assessing Officer. The cost incurred on stamp duty etc. together with the cost incurred in carrying out eviction of the hutment dwellers would certainly add to the value of the asset and thus amount to cost of improvement which is an allowable deduction from the full value of consideration received as a result of the transfer of the capital asset for computing the income under the head 'capital gains'.

31. In so far the fourth ground is concerned, the Assessing Officer has taken the view that long term capital gains arising out of sale or transfer of land would be assessed to tax only in the year in which the land is sold or otherwise transferred by the assessee. Opining that land as a stock is a different item of asset than flats, Assessing Officer held that ownership of land continued to remain with the assessee notwithstanding sale of flat. Therefore, he was of the view that 'capital gains' would be chargeable to tax only in the year when the land is sold or otherwise transferred to the co-operative society formed by owners of the flats and not in the year when individual flats are sold.

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31.1. Assessee has responded to this as can be seen from the grounds urged in the writ petition by contending that if what the Assessing Officer says is correct then there could not be any escapement of income chargeable to tax for the assessment years under consideration; rather excess income has been offered to tax. According to the Assessing Officer, assessee had erred in offering to tax 'capital gains' in the year when the individual flats were sold whereas such 'capital gains' could be assessed to tax only when the land is trasferred to the co-operative society formed by the flat purchasers. If the assessee had offered to tax as 'capital gains' in the assessment years under consideration which should have been offered to tax in the subsequent years, it is beyond comprehension as to how a belief can be formed that income chargeable to tax for the assessment year under consideration had escaped assessment. That apart, the flat purchasers by purchasing the flats had certainly acquired a right or interest in the proportionate share of the land but its realisation is deferred till formation of the co-operative society by the owners of the flats and eventual transfer of the entire property to the co-operative society. In **Prashant S. Joshi** *(supra)*, this Court while examining a challenge to the notices issued under Section 148 of the Act was considering the reasons for issuing such notices. Petitioner in that case was a partner in a particular firm who subsequently retired from the partnership. On his retirement, he received certain amount during the relevant assessment year in full and final settlement of his dues. In the return of income while the assessee disclosed receipt of the said amount, he however did not offer the same to tax on the ground that it was a capital receipt. In the appellate proceeding arising out of the assessment of the partnership firm, the first appellate authority allowed the claim of the partnership firm that the payment of the said amount to the retiring partners should be treated as revenue expenditure. Since the assessee had claimed this to be exempt from income tax by treating it as capital receipt, Assessing Officer stated that there was reason to believe that such receipt had escaped assessment within the meaning of Section 147 of the Act. It was in that context that this Court referred to the judgment of the Supreme Court in *Additional CIT Vs. Mohanbhai*

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Pamabhai, **165 ITR 166** wherein the Supreme Court relied upon its earlier judgments in *Sunil Siddharthbhai Vs. CIT*, **156 ITR 509** and *Addanki Narayanappa Vs. Bhaskara Krishnappa*, **AIR 1966 SC 1300**. Supreme Court held that what is envisaged on the retirement of a partner is merely his right to realise his interest and to receive its value. What is realised is the interest which the partner enjoys in the assets during the subsistence of the partnership by virtue of his status as a partner and in terms of the partnership agreement. Therefore, what the partner gets upon dissolution of the partnership or upon retirement from the partnership is the realisation of a pre-existing right or interest. Supreme Court held that there was nothing strange in the law that a right or interest should exist *in praesenti* but its realisation or exercise should be postponed. Applying the above principle, it can certainly be said that upon purchase of the flat, the purchaser certainly acquires a right or interest in the proportionate share of the land but its realisation is deferred till formation of the co-operative society by the flat owners and transfer of the entire property to the co-operative society.

32. Thus on an overall consideration of the entire matter, it is quite evident that there was no basis or justification for respondent No.1 to form a belief that any income of the assesee chargeable to tax for the assessment years under consideration had escaped assessment within the meaning of Section 147 of the Act. The reasons rendered could not have led to formation of any belief that income had escaped assessment within the meaning of the aforesaid provision. Therefore, in the facts and circumstances of the case, the impugned notices issued under Section 148 of the Act cannot be sustained. Accordingly, the impugned notices dated 25.02.2000 are hereby set aside and quashed.

33. Writ petition is allowed by making the Rule absolute. However, there shall be no order as to costs.

(MILIND N. JADHAV, J.) **(UJJAL BHUYAN, J.)**

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