

IN THE INCOME TAX APPELLATE TRIBUNAL, SURAT BENCH, SURAT
BEFORE SHRI PAWAN SINGH, JUDICIAL MEMBER AND
DR. ARJUN LAL SAINI, ACCOUNTANT MEMBER

ITA No. 173/Srt/2020 (Assessment Year: 2014-15)

(Physical hearing)

D.C.I.T., Circle-2(3), Surat.	Vs.	Swastik Enterprises, R.S. No. 130, F.P. 36, T.P.S. 37, Behind Althan Gam, Althan, Surat. PAN No. AAKFM 1069 M
Appellant/ assessee		Respondent/ revenue

Department represented by	Shri H.P. Meena CIT-DR
Assessee represented by	Shri Rasesh Shah, CA
Date of hearing	07/09/2022
Date of pronouncement	15/11/2022

Order under Section 254(1) of Income Tax Act

PER: PAWAN SINGH, JUDICIAL MEMBER:

1. This appeal by the revenue is directed against the order of learned Commissioner of Income Tax (Appeals)-1, Surat (in short, the Id. CIT(A) dated 20/03/2020 for the Assessment year (AY) 2014-15. The revenue has raised following grounds of appeal:

“1. On the facts and circumstances of the case and in law, the Id. CIT(A) has erred in treating sale of impugned land as long term capital gain without appreciating the facts that the land was treated stock in trade/WIP by the assessee in its own account and the nature of the transactions, therefore would be business income to the extent of Rs. 9,10,73,460/- which has been properly analysed by the Assessing Officer.

2. On the facts and circumstances of the case and in law, the Id. CIT(A) has failed to appreciate the facts that the assessee firm has declared income due to sale of land as LTCG, which was shown as Work in Progress in the balance sheet of the assessee firm and which was capital contribution of the partners and further the objective of the firm was doing business in real estate which were analysed/examined by the Assessing officer and rightly treated the

sale proceeds as the business income to the extent of Rs. 9,10,73,460/-.

3. *On the facts and circumstances of the case and in law, the Id. CIT(A), Surat ought to have upheld the order of the Assessing officer. It is, therefore, prayed that the order of the Id. CIT(A)-1, Surat may be set aside and that of the Assessing officer's order may be restored.*
4. *On the facts and circumstances of the case and in law, the appellant craves its right to add, alter, amend, deleted, any of the ground or grounds of appeal."*

2. Brief facts of the case are that the assessee is a partnership firm, engaged in the business of construction and development of property. The assessee filed its return of income for the A.Y. 2014-15 on 25/07/2014 declaring income of long term capital gain of Rs. 8,70,33,120/-. The case was selected for scrutiny. During the assessment, the Assessing Officer on perusal of computation of income and other details, found that the assessee has shown long term capital gain of Rs. 8.70 crores on sale of land admeasuring 4934 Square meters at block No. 157, T.P. No. 37, F.P. No. 36, being plot No. 36/A, Mauja-Althan, Surat. The Assessing Officer on further perusal of balance sheet, found that the assessee had shown Work in Progress (in short, WIP) of Rs. 89,26,594/- and in preceeding and WIP in current year at Rs. 1,78,53,187/-. The plot of land was held by assessee firm as stock in trade and not as an investment. On the basis of such discrepancies, the Assessing officer issued show cause notice dated 26/10/2016. In the show cause notice, the Assessing Officer asked the assessee as to why the profit on sale of such land may not

be taxed under the head "business income" in place of "capital gain". The assessee filed its reply on 09/11/2016. The contents of reply are reproduced by Assessing Officer in para 4.1 of assessment order. In the reply, the assessee stated that the land admeasuring 6760 Square Meters was purchased by Jagdishbhai Gadhiya and Bharatbhai Patel, partners of the firm. In the partnership deed dated 23/01/2004, the partners agreed to introduce the said land in the firm as their capital contribution. The relevant clauses of partnership deed about capital contribution was also furnished. The assessee further explained that the land was acquired by partners as an agricultural land. The land was introduced with the condition for getting it converted to non-agricultural land and executing necessary declaration and documents for transferring the legal title of land in favour of assessee-firm. The entries in the books of account was passed by crediting their capital account and debiting land. The assessee further stated that the partner of the firm never initiated process of legally transferring the land in the name of firm in the revenue records. Hence, the sale of land was executed by the partner in their individual capacity and not as a partners of the firm. Assessee-firm never carried out any business activity since its inception. The partner never commenced any activity of construction nor received any advance from customer for booking any unit nor assigned any contract. Mere fact that land was classified under head WIP, would not mean that it is a current business asset.

The concept of substance over form must be seen as per its present status since its acquisition and not merely by its classification in financial statement. Capital gain was offered to tax in the firm only because of the said journal entry in the books of the firm. The assessee also relied on certain case laws.

3. The reply of assessee was not accepted by the Assessing officer by taking a view that the assessee had mainly countered that the asset in question is a capital investment and not a business asset. The Assessing Officer held that in the case under consideration, the assessee is a partnership firm, the partners have introduced land as current business asset in the firm, the balance sheet of the firm shows it as WIP, the matter ends without any further question mark. The assessee-firm had himself categorized the asset as business asset. The Assessing Officer held that the assessee is trying to put in that the asset is a capital asset. The formation of partnership with objects of doing business in real estate and reflecting the asset as business WIP are major factors which cannot be ignored. Though, the assessee had not commenced any business activity but the holding of the land was definitely for the purpose of the business. Non commencement of business does not convert the Stock in Trade into Capital Asset, automatically. The entries in the books of account and the final balance sheet also did not show the intentions of converting the stock into capital asset. Some part of the land is still on hold as per the

balance sheet as business WIP. Therefore, the Assessing officer passed by the assessment order vide order dated 17/11/2016 by making the addition of Rs. 9,10,73,460/- by treating the same as business income.

4. Aggrieved by the treatment of capital gain as business income, the assessee filed appeal before the Id. CIT(A). Before the Id. CIT(A), the assessee filed detailed written submissions which is recorded in para 6 of the order of Id. CIT(A). The assessee submitted that the land was introduced as capital asset by the partners for the purpose of asset of the firm. The Assessing officer erred in treating the profit on sale of land as 'business income' instead of 'long term capital gain'. The treatment given by the Assessing officer is incorrect, erroneous, illegal and bad in law. The assessee firm has not engaged in any business activity since its inception. The partners of assessee-firm while introducing the land as capital contribution agreed to execute necessary declaration and documents for transferring the legal titles of the land in favour of assessee-firm and that the land ought to have been treated as asset of the firm only on being registered in the revenue record in the name of firm. As the assessee firm has never undertaken any business for carrying out any development of the said land so as to treat the same as adventure in nature. The partners of the firm never initiated the process of legally transferring the land in the name of firm. The conveyance deed/sale deed in favour of purchaser was executed by the partners in their individual capacity. As

per the revenue record, the firm was never owner of the land. The said land was never stock in trade of the firm and no transaction was carried out pertaining to covering the land towards the business activity. The firm was constituted in Financial Year 2003-04 but never got registration of service tax nor any business activity was commenced. The land was sold after a period of 10 years without commencing any business activity. The appreciation of value of land was only due to efflux of time and not on account of any business activity. The Assessing Officer treated the land as business asset merely for the reasons that in unaudited balance sheet of the firm, the land was classified under "Work in Progress". The accounts of firm are not subject to any audit and are prepaid by accountant who has mistakenly classified the land under WIP without verifying the terms of partnership deed. Merely the land was classified as WIP, would not mean that it is a current business asset. As per the concept of substance over form, an asset should be viewed as per the latest status since its acquisition and not merely by its classification in the unaudited financial statements. Thus, the land cannot be treated as stock in trade of the firm, hence, the gain on sale of land was offered to tax as capital gain and not as an income from business of profession. To support such submission, the assessee relied on certain case laws.

5. The assessee again vide its submission dated 25/2/2020 and 28/02/2020 repeated almost similar submission that the accountant of the firm has wrongly shown the land in the balance sheet as WIP. The assessee further vide its submission dated 06/03/2020 submitted that they have not carried out any business activity. 50% of land was sold to Landmark Corporation which was earlier introduced by the partners as their capital contribution which was lying as such without any development thereon. The assessee has constructed compound wall and payment to Surat Municipal Corporation for development and floor surface index (FSI) charges. The assessee by making reference to Circular of CBDT No. 4 of 2007 dated 15/06/2007 contended that to decide as to whether income from short term capital gain or business income, has been discussed by Bombay High Court in case of CIT Vs. Gopal Purohit (2011) 336 ITR 287 (Bom). If such criteria are applied on the impugned land, the impugned land of the assessee-firm is in the nature of surplus earned on sale of it would be 'capital gain' and not 'business income'. The assessee also tried to impress the different criteria whether asset sold is a capital asset or a trading asset and given certain examples.
6. The Id. CIT(A) after considering the assessment order and the submission of assessee held that the only issue before him is to decide whether the impugned gain is to be taxed under head 'Business income' or 'capital gain'. To decide such issue, one has to first decide

whether the treatment given in Income Tax Act is to be based solely on accounting entry or on the intrinsic nature of transaction or whether the accounting treatment given by assessee should be the sole criteria for deciding the treatment under the tax law. The Id. CIT(A) noted that the taxability of treatment under Income Tax Act cannot be left on the will of assessee, who could make convenient entry in the books of account to avoid taxes. Hence, the accounting entries cannot be the sole criteria. The Id. CIT(A) by referring the case of Natinkant Ambalal Mody Vs SAL Narayan Row (1966) 61 ITR 428 (SC) held that method of book keeping followed by an assessee would not decide under which head a particular income will go. The Id. CIT(A) further noted that the Hon'ble Jurisdictional High Court in Pr.CIT Vs Kalptaru Power Transmission Ltd. (2017) 148 DTR 257 has held that if income does not at all, arise there cannot be a tax, even though in book keeping an entry is made about a hypothetical income which did not materialise.

7. The Id. CIT(A) further noted that the land was brought as a capital by the partners in A.Y. 2007-08. The partnership deed provides that the land will be treated as an asset of the firm on its being registered in the name of firm. The registration in the name of firm was not happened till date of sale. The sale was executed by partners as a seller. However, the capital gain offered in the hand of assessee firm as land was shown as WIP in income tax return. The assessee explained that the WIP was shown due to mistake of accountant but

the intention of assessee firm was to hold it as capital asset which is evident from their conduct. It was also argued that if the assessee firm intended to treat the land as stock in trade, it would not have held it for seven years and would have developed into layout divided into smaller plots and sold it. The Id. CIT(A) held that the land was not developed, no layout or plotting was done. A compound wall was built for protection against encroachment or illegal occupation. The incremental and FSI charges were paid in F.Y. 2010-11 and 2011-12. No other activities were made in the impugned land for seven years. The Id. CIT(A) on the basis of his observation held that the long holding period and absence of any activity for division of land into smaller plots, so the intention of assessee to hold the land for investment for its own business or for appreciation. A business venture required application of mind, efforts, employment skill and time by partners or by employees, no such application is seen in this case. The assessee firm has no office nor debited any expenses since inception. No utilization of human capital or man power. The assessee has not borrowed any capital etc. The Id. CIT(A) also referred certain case laws in para 7.5 of his order wherein gain on sale of land was held as business income wherein the lands were purchased and sold after plotting of land or after conversion into building site which was treated as business income and gain on such sales were treated as business income. The Id. CIT(A) held that no such activities are done by

assessee, therefore, the sale of land cannot be said to be a business transaction, despite the fact that entries as WIP and the gain made by firm is treated as capital gain in the hands of firm. On the aforesaid observation, the Id. CIT(A) reversed the action of Assessing officer and directed the Assessing Officer to treat the surplus earned on the sale of plot as 'capital gain' in place of 'business income'. Aggrieved by the order of Id. CIT(A), the revenue has filed the present appeal before this Tribunal.

8. We have heard the submissions of learned Commissioner of Income Tax/ Departmental Representative (Id. CIT-DR) for the revenue and the learned Authorised Representative (Id. AR) of the assessee. The Id. CIT-DR for the revenue submits that the assessee firm has shown long term capital gain on the sale of land, which was introduced by its partners as their capital contribution as business current asset. The said land was reflected as WIP in the balance sheet of the assessee firm. Such fact is clearly discernible in the balance sheet of assessee as on 31/3/2011 wherein vale of WIP is shown at Rs. 1.56 crores as on 31/3/2012 and value of WIP at Rs. 1.78 crores as on 31/3/2013. Once the assessee firm itself considered the asset which is shown as WIP in the balance sheet, thus the land was the business asset. The Id. CIT-DR invited our attention on the balance sheet wherein the assessee has shown WIP of Rs. 1.78 crores as on 31/3/2013. Further in the capital account of assessee, the same land was shown as capital

contribution. The Id. CIT-DR for the revenue submits that once the partners have introduced the said land as a business asset in the firm, the balance sheet of the firm shown it was a WIP. No further question should be raised in respect of nature of asset and the matter should come to an end without any further doubt or question mark. On perusal of copy of balance sheet, it is clear that the assessee had himself categorised the asset as business asset. The partnership was constituted with the object of doing real estate business and reflecting the asset as a business WIP are major factors which cannot be ignored. The assessee may had not commenced any business activity but introduction of land as capital contribution and holding of land and making payments to Surat Municipal Corporation as incremental charges and FSI charges were definitely for the purpose of business. Non-execution of business will not convert the stock in trade into capital asset automatically. The entries in the books of account and final balance sheet did not show any intention of partners of converting the stock into capital asset. Hence, the income arises on account of sale of WIP cannot be treated as long term capital gain which is nothing but a business income. The assessee himself has admitted before the Id. CIT(A) that they have paid incremental charges and charges of FSI in the office of Surat Municipal Corporation. Such charges can only be paid when the agricultural land was converted into non-agricultural land which itself clearly shows that the assessee was

holding the land for business purposes only. The Id. CIT-DR submits that the assessee firm as per the partnership deed dated 02/10/2006, the partners brought the agricultural land, owned by them in their individual capacity as a capital contribution in firm. Further, the agenda provided that the said land shall be treated as asset of the firm on being registered in Form 7/12 record in the name of firm once the land was introduced as a capital contribution.

9. The Id. CIT-DR for the revenue further submits that when the land is not the asset of the firm, then how the capital gain can be arose in the hand of assessee-frim. The assessee had shown the land as WIP, therefore, the business nature of income was decided on facts. The method of booking keeping followed by assessee would not decide under which head the particular income will go. To support his submission, the Id. CIT-DR relied on the decision of Hon'ble Supreme Court in the case of Natinkant Ambalal Mody Vs Sal Narayan Row (supra). The Id. CIT-DR submits that the various case laws relied by the Id. CIT(A) in his order are not applicable on the facts of the present case rather to some extent support the revenue. The Id. CIT-DR for revenue finally submits that the assessee firm cannot be allowed to blow hot and cold together. On one hand, the land was introduced as capital contribution, thereafter it was allegedly sold by partner and again surprisingly the capital gain is again shown in the hand of

assessee firm. The Id. CIT-DR prayed to reverse the order of Id. CIT(A) and to restore the order of Assessing officer.

10. On the other hand, the Id. AR of the assessee supported the order of Id. CIT(A). The Id. AR submits that the assessee is a partnership firm. The firm is not engaged in any business or other activity since its inception. In the return of income for A.Y. 2014-15, the assessee firm declared long term capital gain of Rs. 8.70 crores on sale of impugned land. The land under consideration was agricultural land purchased by Shri Jagdishbhai Gadhiya and Bharatbhai Patel in their individual capacity. The firm was constituted vide partnership deed dated 23/01/2004. The partners of the assessee firm agreed to introduce the agricultural land in their firm as capital contribution. However, for the purpose of effectively transferring the agricultural land in their firm, certain legal formalities were to be carried out by the partners of the firm. Such formalities are recorded in the various recitals/clauses of partnership deed. The assessee firm never undertook any business on such agricultural land. No financial activities resulting transaction of single rupee was carried out with any person to exploit the said agricultural land so as to treat it as adventure in the nature of land. The agricultural land was converted into non-agricultural land in 2007. The partners of the firm never intended the process of legally transferring the agricultural land so as the name of firm is recorded in Form 7/12 extract in the office of revenue authorities. As per law, the

partnership firm cannot start business unless the impugned land is registered in the name of firm. After conversion of land into non-agricultural land, the firm has not taken step in its name to register the name of assessee in revenue records. The land was never used as a business asset. The ld. AR for the assessee further submits that as per the clauses in the partnership deed, the land was to be treated as asset of the firm only on registration in Form 7/12 record. The firm could not initiate business as the land was not registered in revenue record. The intention to do business will materialize only when the land become the asset of firm. So it can be said that there was no intention to do business. The firm was not registered for service tax. The land was held for almost 10 years. The appreciation in the value of land was only due to efflux of time and not on account of any business activities. The Assessing officer treated the land as business asset on the ground that in the books of account, the assessee has shown WIP. Such entry was made by mistake as shown the land as WIP. The value of WIP only represent the land and expenses for wall, FSI charges and incremental charges paid to Surat Municipal Corporation which was debited to the WIP. Such expenses were not incurred to do any business but were incurred to protect the land and enhance the value of land. The assessee firm was not the legal owner of the asset. The capital gain should be arising in the hands of partners who sold the land and who did not execute the document on behalf of firm. No

income from business or capital gain arises in the case of assessee-firm. The Id. AR further submits that the FSI charges was paid by the firm but legal ownership vested with the partners and therefore, partners are benefitted until the firm became legal owner of the land. The FSI charges were paid to get the appreciation of value of land. On the specific submission of Id. CIT-DR that the assessee has shown capital gain in the name of firm and FSI and other charges were incurred by the assessee firm, the Id. AR submits that due to mistake, the land was shown as WIP although there was no WIP, so the mistake was apparent. To support his submission, the Id. AR of the assessee in his written submissions has relied on the following case laws:

- Nalinkant Ambalal Mody Vs S.A.L. Narayan Row, CIT (1966) 61 ITR 0428 (SC),
- D.L.F. Housing & Construction (P) Ltd. Vs CIT (1982) 9 Taxman 207 (Delhi),
- CIT Vs India Discount Co. Ltd. (1970) 75 ITR 0191 (SC),
- CIT Vs Suresh Chand Goyal (2007) 163 Taxman 54 (MP),
- Automobile Products of India Ltd. (1983) 140 ITR 159 (Bom),
- Gordhandas Trikambhai Patel (1979) 118 ITR 81 (Guj),
- Kettlewell Bullen & Co. Ltd. (1964) 53 ITR 261 (SC),
- Tribhuvandas Vallabhdas s CIT (1966) 61 ITR 518,
- G. Venkataswami Naidu & Co. Vs CIT (1959) 35 ITR 594,
- Vasupujya Properties Pvt. Ltd. and Ors. Vs ITO (ITA 912 to 923/PN/2002) (Pune Trib) order dated 31/05/2006.

11. At the time of making submissions, the Id AR for the assessee relied on the following case laws;

- ❖ CIT Vs India Discount Co. (1975) 75 ITR 191 SC,

- ❖ Smt. Indiramati Bai & Others Vs ACIT (1983) 200 ITR 594-SC,
- ❖ Raja J. Rameshwar Rao Vs CIT (1961) 42 ITR 0179 SC,
- ❖ CIT Vs Suresh Chand Goel (2007) 164 TAXMAN 54 (MP HC) and
- ❖ Hariom Associates Vs ITO (ITA No. 1516/Pun/2016).

12. We have considered the rival submissions of both the parties and have also gone through the orders of the lower authorities carefully. We have also deliberated on the various case laws relied upon by the lower authorities as well as by the Id. AR of the assessee. We find that in the return of income, the assessee firm had shown capital gain on sale of impugned land in the hand of assess-firm. However, the Assessing officer treated the said gain as 'business income' by taking a view that assessee had mainly countered that the asset in question is a capital investment and not a business asset. The Assessing Officer held that assessee is a partnership firm, the partners have introduced land as business current asset in the firm, the balance sheet of the firm shows it as WIP, the matter ends without any further question mark. The assessee had himself categorized the asset as business asset. The Assessing Officer held that the assessee is trying to put in that the asset is a capital asset. The formation of partnership with objects of doing business in real estate and reflecting the asset as business WIP are major factors which cannot be ignored. The assessee had not commenced any business activity but the holding of the land was for the purpose of the business. Non commencement of business does not convert the Stock in Trade into Capital Asset, automatically. The

entries in the books of account and the final balance sheet also did not show the intentions of converting the stock into capital asset. Some part of the land is still on hold as per the balance sheet as business WIP and treated the gain on sale of plot as business income in place of capital gain.

13. The Id. CIT(A) reversed the action of Assessing Officer by taking a view that long holding period and absence of any activity for division of land into smaller plots, so the intention of assessee to hold the land for investment for its own business or for appreciation. A business venture required application of mind, efforts, employment skill and time by partners or by employees, no such application is seen in this case. The assessee firm has no office nor debited any expenses since inception. No utilization of human capital or man power. The assessee has not borrowed any capital etc. The Id. CIT(A) referred certain case laws wherein gain on sale of land was held as business income wherein the lands were purchased and sold after plotting of land or after conversion into building site which was treated as business income and gain on such sales were treated as business income. The Id. CIT(A) held that no such activities are done by assessee, therefore, the sale of land cannot be said to be a business transaction, despite the fact that entries as WIP and the gain made by firm is treated as capital gain in the hands of firm.

14. The word 'business' has been defined under section 2(13) of Income-tax Act, which include any trade, commerce or manufacture or any adventure or concern in the nature of trade. It is settled position under law that even a single transaction or activity can also be a part of business, if it bears a clear indication of trade. If we examine the facts of the present case, we find that the order of Id. CIT(A) is contrary to the facts of the case. There is no dispute that partners of the assessee-firm introduced the impugned land as their capital contribution, which was certainly for the purpose of business. The assess-firm has incurred expenses for boundary wall, paid incremental and FSI charges in the office of Surat Municipal Corporation, such expenses were incurred for the purpose of business. Such expenses were debited in the profit and loss account of the assessee-firm and not in the individual hand of the partners of assessee-firm. Surprisingly, the sale deed of the land was executed by partners of the assessee-firm. Again, no capital gain is shown in the hand of the partners for the reasons best known to them. Despite the fact the sale deed was executed by the partners, the capital gain is shown in the hand of assess-firm. The partners of the assessee-firm are acting in accordance with their whims and choice. Once, the land/ plot was introduced as a capital contribution, it loses its control from the hand of the partners of the assessee, as it became the asset of the assess-firm. Now, the partners are raising plea that the accountant of the firm has made wrong entry. No corrective step is

shown to have been taken by the partners in showing such expenses in their personal account, as no such evidence is placed on record. Thus, the stand of partners is contrary. The formation of partnership was with the objects of doing business in real estate and such conduct is reflected as asset as business WIP are major factors which cannot be ignored. There is no clause in the partnership deed about making investment in the land and to earn capital gain only. When the expenses were incurred, it was shown at WIP, however, when the asset is sold, the partners claimed that it was as investment only and not business asset, which cannot be allowed. Thus, in our view the Id CIT(A) erred in treating / directing the assessing officer to treat the gain on sale of asset of firm as capital gain in place of business income. Thus, we reverse the order of Id CIT(A) and fully concur with the finding of assessing officer, with our aforesaid observation.

15. The ratio in series of case laws relied by Id AR for the assessee are not applicable on the facts of present case. In all case laws facts are quite different. The first three cases referred in para-10 above deals with the treatment accounting entry. The case law at serial No. 4 in Suresh Chand Goel (supra), the land was sold by making plotting, the land was sold in individual capacity, however, in the present case the land was introduced as capital contribution as business asset in the firm. Similarly, in none of the case, as relied by assessee, there was no dispute on the nature of asset. The facts in the present case is unique

as initially it was introduced as capital contribution, development charges of FSI was paid in Surat Municipal Corporation, it was sold in individual capacity but capital gain was again shown in the hand of assess-firm, when such glaring fact was detected by assessing officer, the partner took the plea that accountant committed mistake, which was never corrected. In the result, the grounds of appeal raised by the revenue are allowed.

16. In the result, this appeal of revenue is allowed.

Order pronounced in the open court on 15th November, 2022.

Sd/-
(Dr. ARJUN LAL SAINI)
ACCOUNTANT MEMBER

Sd/-
(PAWAN SINGH)
JUDICIAL MEMBER

Surat, Dated: 15/11/2022

**Ranjan*

Copy to:

1. Assessee –
2. Revenue -
3. CIT(A)
4. CIT
5. DR
6. Guard File

By order

Sr.Private Secretary, ITAT, Surat