Analysis of three important decisions – June 2012 to August 2012.

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1. Capital Gains exemption u\s 54 – Mumbai Tribunal decision – Jatinder Kumar Madan vs. ITO – [2012] 26 SOT 583 {Mum}{Trib} - Surrender of a residential flat in an existing building by assessee to a developer under a development agreement in lieu of another flat to be allotted to him in the new building to be developed. Held - Agreement amounts to construction of new flat by assessee and not purchase.

Under the provisions of section 54, an assessee is entitled to exemption in respect of long term capital gains resultant from transfer of residential premises, if he either purchases another residential premises within a period of two years or constructs a residential premises within three years from the date of the transfer. In the case before the Mumbai Tribunal cited above, the assessee had entered in to a development agreement with a developer under which he had agreed to surrender his residential flat in an existing building in lieu of a another flat agreed to be allotted by the developer in the building proposed to be re-developed. Before the Assessing Officer, the assessee had canvassed his claim for exemption u\s 54 on a proposition that the development agreement amounted to an agreement for construction of a new flat by the developer on his behalf and this being so, he ought to be entitled to the exemption as the construction of the flat had been completed within a period of three years from the date of surrender of his old flat. In assessment, this claim of the assessee had been turned down by the Assessing Officer. The assessee's appeal to the Appellate Commissioner was also dismissed

The Mumbai Tribunal has held, in favour of the assessee, that acquisition of a new flat under a development agreement in exchange for the old flat amounts to construction of a new flat. In coming to this conclusion, the Mumbai Tribunal has drawn support from a decision of the Bangalore Tribunal in the case of ITO vs. Abbas Ali Shiraz reported in [2006] 5 SOT 422 {Bang}. Here, the Bangalore Tribunal had found that the development agreement of the assessee amounted to construction of a new flat and not purchase.

In cities like Mumbai, where development of properties is taking place in every nook and corner at hectic pace, this decision of the Mumbai Tribunal should definitely attract special attention. Nowadays, where the redevelopments of buildings are of at least seven storey, it is more likely that the reconstruction will be completed within three years rather than two years. In such scenario, an assessee, who has surrendered his existing flat to a developer in lieu of another flat to be allotted in the new building, should certainly find himself more comfortably placed before the tax authorities - canvassing his claim for capital gains' exemption u\s 54 on the basis of 'construction' rather than 'purchase' as a larger period of three years in available to him for compliance of the exemption conditions.

Looking ahead, it is also possible to support the Mumbai Tribunal decision with further reasoning. There is a marked difference in re-development of a tenanted building and re-development of a building owned by a co-operative housing society. In case of society, thought the legal title of the land and the building vests with the society, the same is subject to the possessory rights enjoyed by the shareholders in respect of the flats allotted to them. If there is any extra FSI, a shareholder has no individual property rights in the same and the extra FSI should technically vest in the society. Of course, when the society is being wound up, he would be entitled to an equitable share in the realization proceeds of net assets of the society. However, during the tenure of the society, the members would be entitled to cause the society to demolish the existing building and construct a new building, in which case, the members could be proportionately allotted flats even larger than the ones in the existing building. In this process, each flat owner-shareholder gets a chance to appropriate to himself some portion of the extra FSI available with the society.

There are two alternative modes available to the society for such re-development. In the first mode, the society can construct the building at its own cost and risk by employing a contractor. In the second mode, the society can entrust the construction work to a professional developer, who will undertake the construction at his own risk and cost, allot flats free of cost to the existing shareholders and recover the construction costs by selling the remaining saleable area in the building in his own right.

Even in the second mode, according to me, it is a possible line of thinking that the acquisition of the new flat by the existing shareholder from the developer in the new building is a case of 'construction' and not' purchase'. I shall briefly narrate my reasons for saying so.

At the outset, it is pertinent that the flat owner, despite surrendering the possession of his flat to the developer for re-development, continues to be the shareholder in the society. By virtue of this, his entitlement to one flat in a building of the society remains intact.

Even qua the existing flat, there is no 'transfer' of property, in general law, by the flat owner to the developer - when he hands over the possession of the flat to the developer for re-development. The position, in general law, would be that while the flat owner loses his existing flat when the building is demolished for re-development, there is no passing of the property rights in the flat to the developer. The developer, after all, does not get any right to enjoy this flat to his own self or sell it to anybody. The possession of the flat is being given only to enable the demolition of the building for re-development.

There is, therefore, no passing of rights in the existing flat from the flat owner to the developer so as to attribute a 'transfer' in general law. It is only that a 'transfer' is imputed under the income tax provisions because of the special definition of 'transfer' u\s 2 [47] of the Income Tax Act. It may be noted that section 2 [47] gives an extended meaning to the expression 'transfer' for capital gains' purposes, by also including within its ambit items which do not normally constitute 'transfer' under general law. For example, the definition of 'transfer' in section 2[47] also includes extinguishment. When a property is destroyed, there is logically an 'extinguishment' of the owner's rights in the same as the property no longer survives. In such a case of extinguishment, there is no passing of rights from the owner to anybody else. Yet, because the definition of 'transfer' includes 'extinguishment', there is a 'deemed transfer' and the compensation received for the extinguishment is treated as the transfer consideration for capital gains purposes. {See CIT vs. Grace Collis [2001] 248 ITR 323 {SC}}.

Therefore, where a flat owner surrender the possession of his existing flat in the society building to a developer, there is only extinguishment and not an 'exchange' of an existing flat for a new flat. As far as the developer is concerned, his property rights relating to the new building can be understood to be lying in two portions i.e. the non-saleable and the saleable. **The flat owners, who have surrendered the possession of their existing flats to the developer for re-development, continue as shareholders of the society and by virtue of this, they continue to be entitled to one flat each in the new building also. These rights thus remained preserved in the new building also. Therefore, it cannot be said that the developer is selling the flats to the existing shareholders. What he is doing is only constructing the flats for them on their own 'spaces'.** The sales of the developers would be only to non members.

Therefore, it can be argued that the redevelopment of an existing society building only involves a case of 'construction' and not ''purchase'. This reasoning, I feel, should also support the decision of the Mumbai Tribunal cited above.

Despite the above, it is advisable that the agreements between developers and flat owners should be carefully drafted to resemble 'construction agreements' rather than 'purchase agreements'. This would reduce adversities in the tax litigations to which assessees may be exposed with the income tax department.

2. Fate of assessee in a fresh assessment pursuant to remand by Tribunal – Assessee cannot be worse off than what he was in original assessment order – Mumbai Tribunal decision in Kellogg India Pvt. Ltd vs. ACIT - source www.itatonline.org

In a practical decision delivered in the above case, the Mumbai Tribunal has held that the assessee, in a fresh assessment order pursuant to a remand by the Tribunal, cannot be worse off then what he was in the original assessment order.

The facts of this case are that the Assessing Officer passed an assessment order u\s 143(3) in which he disallowed 50% of the expenditure on an ad-hoc basis. This was reduced to 25% by the CIT (A). On further appeal by the assessee, the Tribunal set aside the matter to the AO to examine the issue afresh. In the second round of appeal, the AO disallowed 100% of the expenditure on the ground that the assessee had already claimed the same expense under some other head and that there was a claim for double deduction. This was upheld by the CIT (A). Before the Tribunal, the assessee argued that once a matter has been set aside by the Tribunal, the assessee cannot be put into a worse situation than what it was at the time of original assessment.

Upholding the plea of the assessee, the Tribunal held that it is a settled proposition of law that the Tribunal u/s 254(1) has no power to take back the benefit conferred by the Assessing Officer or enhance the assessment. Once the matter has been restored by the Tribunal, the income cannot be enhanced from what was determined at the time of original assessment proceedings, which was the subject matter of dispute before the Tribunal. This proposition of law has been upheld by the Supreme Court in Hukumchand Mills Ltd 62 ITR 232 (SC) and reiterated in Mcorp Global 309 ITR 434 (SC). Therefore, the enhancement of assessment by making 100% disallowance in respect of free food allowance cannot be sustained and the same is restricted to 50%, as was made by the AO in the original round of proceedings.

Readers may note that in the Hukumchand case, the Supreme Court had observed that the powers of the Tribunal are different from the powers of the Commissioner {Appeals}. Whereas the powers of the Commissioner {Appeals} are co-terminus with that of the Assessing Officer and include the powers to enhance the assessee's income in the appeal, the powers of the Appellate Tribunal are narrower and confined to the subject matter of the appeal and nothing more. The Appellate Tribunal cannot therefore enhance the income of the assessee or make him worse of the appeal than what he was in the assessment. This decision has been later followed by the Supreme Court in its subsequent decision in the case of Mcorp Global P. Ltd. cited above.

We have seen that the Kellog's case was tested qua the scope of the Tribunal's powers. According to me, the decision can also be supported by testing it with the powers of the Assessing Officer in a remand proceedings.

In the Kellog's case itself, when the appeal came for the first time before the Tribunal against the original assessment order, the Tribunal had two options before it. Firstly, it could have either decided on the issue before as to whether the disallowance ought to be 50 % as determined by the Assessing Officer or less. In no case, it could have held that the disallowance ought to be more than the 50% decided by the Assessing Officer. In the alternative, it would have set aside the assessment on this issue to the Assessing Officer to decide **what it could have otherwise decided on its own**. It chose to follow the second alternative of remanding the issue back to the Assessing Officer for consideration.

It should be clear, from the above, that the powers of the Assessing Officer in the remand proceeding are 'delegated' powers and these cannot be equated with his 'own' powers as in the original assessment. The powers of the Assessing Officer as a delegate can never exceed the powers of his grantor, the Appellate Tribunal. The Assessing Officer, in this situation, cannot therefore do what the Tribunal itself could not have done in the first instance i.e. enhance the disallowance. Any enhancement made by the Assessing Officer, despite the above legal position, would amount to usurping a power which he does not own. The Mumbai Tribunal decision can therefore be supported by this reasoning also.

The above decision of Mumbai Tribunal should therefore serve as an useful guide to assessees in cases, where the entire assessment has not set aside by the Tribunal for doing afresh, but where the set aside has been directed to the Assessing Officer - only for the limited purpose for considering a particular issue [say a disallowance] which was the subject matter of dispute before the Tribunal. In a scenario, where a large number of appeals are being set aside by the Tribunal to the Assessing Officer for considering the issues before it afresh, the decision should be seen as both timely and of practical importance.

3. Delhi High Court decision in CIT vs. Anil Kumar Bhatia [source www.itatonline.org.] - S. 153A applies if incriminating material is found even if assessments are completed. However, the question as to whether s. 153A can be invoked in a case where no incriminating material is found during search left open.

The facts of the case are that pursuant to a search u/s 153A, the AO passed an assessment order in which he assessed various amounts. The Tribunal {decision reported in 1 ITR (Trib) 484)} upheld the assessee's appeal on the ground that (a) no "incriminating material" was found in the course of search and (b) as the income tax returns for the said six years disclosed the particulars of the subject additions and these had been accepted by the AO u/s 143(1), no assessment was pending so as to have abated. It was held that s. 153A was not a de novo assessment or a normal/ regular assessment and the additions made therein have to be necessarily restricted to the undisclosed income unearthed during the search.

On appeal by the department to the High Court, held reversing the Tribunal as under:-

(i) U/s 153A, the AO is empowered to assess or reassess the "total income" (which includes the disclosed & undisclosed income) of six years. This is a significant departure from the earlier block assessment scheme (s. 158BC) in which only the undisclosed income could be assessed. U/s 153A, there can be only one assessment order in respect of each of the six assessment years, in which both the disclosed and the undisclosed income would be brought to tax. If the assessment proceedings are pending completion when the search is initiated, they will abate making way for the AO to determine the total income of the assessee in which the undisclosed income would also be included. If the assessment proceedings have already been completed, there is no question of any abatement since no proceedings are pending & the AO will have to reopen the assessments (without having the need to follow the strict provisions or complying with the strict conditions of s. 147, 148 & 151) and determine the total income of the assessee;

(ii) The Tribunal's view that since the returns filed by the assessee for the six years had been processed u/s 143(1)(a) before the search took place, s. 153A cannot be invoked is not correct. The AO has the power u/s 153A to make assessment for all the six years and compute the total income of the assessee, including the undisclosed income, notwithstanding that ROIs were filed which stood processed u/s 143(1)(a);

(iii) On facts, the Tribunal's finding that no material was found during the search is factually unsustainable since the entire case and arguments had proceeded on the basis that the document embodying the transaction was recovered from the assessee. If a document is

found in the course of the search, s. 153A is triggered & it is mandatory for the AO to complete the assessment u/s 153A.

However, the question, as to whether s. 153A can be invoked in a case where no incriminating material, is found during search, was left open by the Delhi Tribunal as the same was not issue before it.

In this analysis, we would be considering not the issue decided by the Delhi High Court, but the issue left open. i.e. whether the provisions of section 153A can be invoked in a case where no incriminating material is found during the search.

The provisions of section 153A [1] begin with a non obstante expression *'Notwithstanding anything contained in section 159, section 147, section 148, section 149, section 151 and section 153,'*. This shows that there is an override of the provisions of section 153A over these section. The assessment provisions of section 143 [3] do not find a mention in this over ride. On the contrary, the Explanation appended below section 153A cites that *'for removal of doubts, it is hereby declared that (i) save as otherwise provided in this section, section 153B and section 153C, all other provisions of this Act shall apply to the assessment made this section'.* A reading of the provisions of section 153A [1] together with the Explanation brings out a case that the assessment procedure in section 153A shall be followed in tandem with the provisions of section 143 also.

Now, clause (a) of section 153 A [1] requires the Assessing Officer to issue a notice on the person searched to file a return for each of the six assessment years concerned . This clause also states that the *'provisions of this Act, shall so far as may be, apply accordingly as if such return were a return required to be furnished under section 139'*.

We have seen above that while the Legislature has set out a special assessment procedure for search assessments, it has not done away with the assessment procedure in section 143 . Let us now peruse the assessment provisions of section 143. The regular assessment procedure is prescribed in sub-section [2] and [3]. Sub-section [2] is very pertinent in context of the issue being discussed.

The provisions of sub-section [2] read that ' Where a return has been furnishes u\s 139, the Assessing Officer shall – (ii) notwithstanding anything contained in clause (i), if he considers it necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not under-paid the tax in any manner, serve on the assessee a notice requiring him, on a date to be specified therein, either to attend his office or to produce, or cause to be produced, any evidence on which the assessee may rely in support of the return:'.

This is followed by the provisions of sub-section [3], which outlines the procedure to be followed by the Assessing Officer after he has initiated the assessment proceedings in accordance with sub-section [2].

Coming back to the provisions of section 153A [1], we have seen that it is cited therein the same assessment procedure will be applied to a return filed u\s 153A as would have applied to a return filed u\s 139. We have also seen above that Explanation to section 153A cites that *'for removal of doubts, it is hereby declared that (i) save as otherwise provided in this section, section 153B and section 153C, all other provisions of this Act shall apply to the assessment made this section'*. We have also seen above that the provisions of section 143 have not been overridden in the provisions of section 153A[1]. All these would mean that the assessment procedure u\s 143 [2] and 143 [3] should apply to a return filed u\s 153A [1] in the same manner as if it were a return filed u\s 139.

It is not correct that an Assessing Officer has unfettered powers to initiate assessment proceedings u\s 143 [2] on any return he likes at his free will and whims and without any conditions attached. The correct view is that an Assessing Officer can initiate assessment proceedings only if the mandatory jurisdictional pre-conditions are satisfied. And these mandatory jurisdictional pre-conditions are prescribed in the provisions of section 143 [2] to the effect he must 'consider it **<u>necessary or expedient</u>** [emphasis supplied in bold underline to alert the readers] to ensure that that the assessee has not understated his income, not computed excessive loss or under paid his tax'**. The existence of such 'necessity or expedience' must be genuinely shown to exist by the Assessing Officer [just like existence of 'belief' that income has escaped assessment in the provisions of section 147] and must not be a mere show or pretence.**

Therefore, in the case where a return has been filed u\s 153A , unless and until the Assessing Officer genuinely considers that a 'necessity or expediency' exists to test the return for understatement of income, he should not engage the assessee in an assessment proceedings. The Assessing Officer will have to record the reasons for this necessity or expediency because the Court may ask him to prove its existence. The assessee should be entitled to a copy of the same after the assessment proceedings has commenced. If the reasons cited by the Assessing Officer in his record are flimsy, he shall be entitled to object to the Assessing Officer that assessment proceedings have been initiated without jurisdiction and must be dropped. He can even apply to the Court in a writ to quash the proceedings.

And where there is no incriminating evidence found at the time of the search, the onus will be heavy on the Assessing Officer to prove that the return still requires investigation on some other count. This will be more particularly so when a previous assessment has been done u\s 143 [3] and the return filed u\s 153A is at the same figure as the income assessed.

This is view which the readers may consider.