**IN THE INCOME TAX APPELLATE TRIBUNAL,
BANGALORE A BENCH, BANGALORE**

[Coram: Pramod Kumar AM and P Madhavi Devi JM]

I.T.A. No.: 1709/Bang/2013
Assessment year: 2010-11

Dheeraj Amin **…………………Appellant**
J V Builders, 1st floor, J V Son Building
Hampankatta, Mangalore 575 001
[PAN: ADPPD6279E]

Vs.

Assistant Commissioner of Income Tax
Circle 2(1), Mangalore **………………Respondent**

Appearances by:
V Srinivasan, *for the appellant*
TSN Murthy, *for the respondent*

Date of concluding the hearing : April 15, 2014
Date of pronouncing the order : June 30, 2014

O R D E R

Per Pramod Kumar, AM:

1. This appeal, filed by the assessee, is directed against the order dated 10th July 2013 passed by the learned Commissioner of Income Tax (Appeals) in the matter of order under section 143(3) of the Income Tax Act, 1961, for the assessment year 2010-11.

2. Grievance of the assessee, in substance, is that the learned Commissioner (Appeals), on the facts and in the circumstances of this case, erred in sustaining the addition of Rs 17,28,81,276 in respect of short term capital gains said to be arising on entering into a development agreement with Menorah Realties Pvt Ltd, though with a modification that this gain is to be taxed as business income of the assessee by reducing the cost of acquisition of share in the undivided

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property transferred and by adding the value of share in constructed area in the closing stock. It is on this ground of appeal that we have heard the parties.

3. The issue in appeal lies in a very narrow compass of material facts. The assessee before us is an individual and is engaged in the business, *inter alia*, as a builder in the capacity of proprietor of JV Builders. The assessee was absolute owner of a piece of land, admeasuring 1 acre and 96.22 cents, at Casa Bazar Village of Mangalore Taluk but this land, as is the unchallenged finding of the CIT(A), was held as stock in trade. It is in respect of this land that, on 7th May 2009, the assessee entered into a development agreement with Menorah Realties Pvt Ltd (MRPT, in short). Under the terms of this agreement, MRPT was to construct a residential apartment building, consisting of 24 floor and named as 'Alexandria', at its cost, and, in consideration of the land of the assessee being used for this project, MRPT was to give 40% of total saleable construed area, parking spaces and undivided interest in the said property. In effect thus, the assessee was to transfer entire land holding to this project, and, in consideration of the land being used for this housing project, receive 40% of total saleable area, parking space and undivided interest in the property. By way of a subsequent modification to this agreement, in consideration of delay in execution of project, the assessee was to get an additional 2% share in the constructed area, parking space and undivided interest in the property. On these facts, the Assessing Officer, vide show cause notice dated 14th December 2012, required the assessee to show cause as to why the capital gains arising on transfer of capital asset via the joint development agreement dated 7th May 2009 not to be brought to tax in this assessment year i.e. 2010-11. It was, however, contended by the assessee that even though the assessee had entered into a development agreement in the relevant previous year, no gains arose as a result of this agreement since the proposed building project was not even cleared by the regulatory bodies. It was pointed out that the licence to construct the building project was received in the subsequent previous year, and, therefore, no capital gains could be said to have been arisen in this year. The Assessing Officer did not accept the plea so advanced by the assessee. The

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Assessing Officer noted that, in terms of the clear provisions of Section 45(1), profit and gains arising from the transfer of a capital asset effected in a previous year are to be brought to tax as income of the previous year in which the transfer took place. It was further noted that in terms of the provisions of Section 2(47)(v), "transfer" includes "any transaction involving he allowing of possession of any immoveable property to be taken or retained in part performance of a contract of the nature referred to in Section 55A of the Transfer of Property Act, 1882". A reference was then made to the decision of Hon'ble jurisdictional High Court, in the case of **CIT Vs Dr T K Dayalu [(2011) 202 Taxman 531 (Kar)],** wherein it is held that the capital gains will arise in the year in which full control and possession of the land in question is given. A reference was also made to Hon'ble Bombay High Court's judgment in the case of **Chatubhuj Dwarkadas Kapaida Vs CIT [(2003) 260 ITR 491 (Bom)],** which was so followed by Hon'ble Karnataka High Court, in arriving at this conclusion in Dr T K Dayalu's case *(supra).* The Assessing Officer thus proceeded to compute the capital gains by taking the cost of construction of assessee's share in the built up area as consideration for which the land was transferred. It was in this background that the Assessing Officer computed the short term capital gains as follows:

The Short Term Capital gain is worked out as under:

Total area in square feet*	**3,07,000.66 sq. ft.**
Assessee's share in this *	**1,28,940.26 sq. ft.**
Cost of construction	**Rs. 1,654** *(per sq ft)*
Deemed sales consideration	**Rs.21,32,67,190**
Less: Cost of Acquisition	**Rs. 6,89,65,045**
Less: Cost of improvement	**Rs. 6,65,842**
	Rs. 6,96,30,887
58% of the above	**Rs. 4,03,85,914**
	Rs.17,28,81,276

*(*in the housing project)*

4. Aggrieved by the addition of Rs 17,28,81,276 so made by the Assessing Officer, assessee carried the matter in appeal before the CIT(A) but without much success. While learned CIT(A) agreed that notional profit of transfer of

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land could indeed not be taxed as capital gains, he was of the view that it would be taxable as business profits because, as against reduction of closing stock due to transfer of interest in land, the closing stock of the assessee has to go up by the notional value of the gains inasmuch as closing stock of rights in constructed area in the project to be developed is to be taken at estimated cost of construction to which the assessee was entitled without incurring any costs. While holding so, learned CIT(A), *inter alia*, observed as follows:

> **3.7 I have considered the rival contentions carefully. As could be seen from the JDA pg no.3, clause 1 – it reads as follows :**
>
> > ***"1. That the land owner has hereby entrusted the schedule property to the promoter ………………."***
>
> **Further, page no.4, clause 3 starts as follows:**
>
> > ***"3. (A) the parties have further agreed that in consideration of the land owner having provided the scheduled property for the promoter for the project the promoter shall ………"***
>
> **3.8 All these conditions clearly show that the possession of the property is already given to the developer. Though Clause 7 on page 7 says that such possession should not be treated as possession u/s 53A of Transfer of Property Act, such a clause is not tenable since it is not as per law. Further, page no. 8 clause 12 clearly shows that the land owner shall execute irrevocable GPA in respect of the property in favour of promoter. Reading together various clauses of the agreement, the clear understanding of the facts is that, the possession of the property is given to the promoter for development of the project. The obligation is only to return back the specified percentage of developed area with undivided share of land to the owner and the promoter will retain the balance. Hence, the character of the property is intended to be changed by virtue of this JDA. It is relevant to quote here the provisions of Section 4, section 5 and section 6 of Sale of Goods Act which are as follows:**
>
> > ***"4. (1) A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. There may be a contract for sale between one part-owner and another;***
> >
> > ***(2) A contract of sale may be absolute or conditional.***
> >
> > ***(3) Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale,***

but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.

(4) An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred. "

5. (1) A contract of sale is made by an offer to buy or sell goods for a price and the acceptance of such offer. The contract may provide for the immediate delivery of the goods or immediate payment of the price or both, or for the delivery or payment by instalments, or that the delivery or payment or both shall be postponed.

(2) Subject to the provisions of any law for the time being in force, a contract of sale may be made in writing or by word of mouth, or partly in writing and partly by word of mouth or may be implied from the conduct of the parties. "

6. (1) The goods which form the subject of a contract of sale may be either existing goods, owned or possessed by the seller, or future goods.

(2) There may be a contract for the sale of goods the acquisition of which by the seller depends upon the contingency which may or may not happen.

(3) Where by a contract of sale the seller purports to effect a present sale of future goods, the contract operates as a agreement to sell the goods."

3.9 From the details filed by the appellant, I find that the appellant has been showing the property as stock in trade. However, by virtue of transfer of Property Act, in view of the JDA agreement and reading together transfer of Property Act and Sale of Goods Act, I am in agreement with the AO that the transfer and the consequent sale has taken place in the year when JDA has been entered . What is sold is 60% of the land or 58% as the case may be reading together the subsequent agreements and the consideration thereof is the construction cost of 42% share of the appellant. This value will go to the closing stock of the appellant since it is resulting in a different stock in trade in the form of constructed buildings eventually. Further, since the appellant did not furnish the working behind accepting 42% share, estimation is the only way left with the Department to arrive at the value of the consideration based on the material available before the AO at the time of assessment. Hence, since the relevant material is available before the AO to estimate and the appellant himself has given his version of estimation in the statement, I find that the AO's estimation was reasonable.

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> **When questioned about as to when the plan was submitted, since that is the time when both the parties would know the possible area of construction, it was explained by the AR that it was soon after the JDA. Though the approval came much later, it means that soon after the JDA both the parties knew the possible areas in the given piece of land. Further, it is in the common knowledge that while working out the percentages the possible areas are one of the main considerations that are taken in to account. Hence, I am of the considered view that there is a transfer in the form of sale resulting in profit and also the transactions is resulting in increased closing stock which needs to be evaluated by the AO and assessed accordingly. Hence, the AO is directed to assess the income under the head profit and gains of business instead of Capital Gains in the above lines by treating the transaction as that of sale of 60% land for a consideration in kind for which value is to be estimated in the form of 40% developed area which is again taken to closing stock after reducing the cost of the share of 60% of land sold The trading accounts has to recast accordingly.**

5. The assessee is aggrieved of the stand so taken by the CIT(A) and is in appeal before us. On the other hand, as confirmed by the learned Departmental Representative appearing before us, the Assessing Officer is not in appeal or cross objection before us.

6. We have heard the rival contentions, perused the material on record and duly considered facts of the case in the light of the applicable legal position.

7. In view of the uncontroverted findings by the learned CIT(A), it is now a settled position that the land transferred by the assessee was held as a part of stock in trade and the gains on the transfer of this land could only arise by the virtue of the increase of closing stock value in respect of the right to 42% share in the constructed building. There is no appeal or cross objection against the order passed by the CIT(A) and the learned representative state so at the bar.

8. Once the land is held to be a part of the stock in trade, it ceases to be a capital asset in view of the fact that Section 2(14), as it stood at the material point of time, specifically provided that the expression "**capital asset**", which means "**property of any kind held by an assessee, whether or not connected with the his business or profession, but does not include (i) any stock-in-**

trade, consumable stores or raw material held for the purpose of business or profession…………..". Clearly, therefore, the provisions regarding capital gains are admittedly not attracted on the facts of this case.

9. Once we come to the conclusions, as is inescapable in the light of the above position, that the provisions regarding capital gains are not attracted, the definition of 'transfer' under section 2 (47) of the Act, and of Section 53A of the Transfer of Property Act- which is relevant in the Income Tax Act only for the limited purposes of connotations of expression 'transfer' under section 2(47) only, have no bearing on the adjudication about taxability of notional profits in the hands of the assessee. While on this issue, we may also mention that learned Departmental Representative's reliance judgment of Hon'ble jurisdictional High Court in the case of Dr T K Dayalu *(supra)*, as also on Hon'ble Bombay High Court's judgment in the case of Chaturbhuj Kapadia *(supra),* is wholly misplaced at both of these judgments are in the context of the computation of capital gains and in the context of connotations of the expression 'transfer' under section 2(47) – things which, or the reasons set out above, are wholly irrelevant in the present context.

10. Let us, in this light, revert to the findings of the CIT(A) wherein, relying upon the provisions of Section 53A of the Transfer of Property Act, he comes to the conclusion that the transaction is in the nature of sale, by stating that "**by the virtue of** *(section 53A of the)* **Transfer of Property Act, in view of the JDA agreement and reading together transfer of Property Act and Sale of Goods Act, I am in agreement with the AO that the transfer and the consequent sale has taken place in the year when JDA has been entered**". *(Emphasis by underlining supplied by us)*.

11. Learned CIT(A) was completely in error in coming to these conclusions. Relevance of Section 55A of the Transfer of Property Act, at the cost of repetition, is only for the purpose of transfer under section 2(47) which, in turn, is relevant, as it states in so many words by using the expression "transfer", in

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relation to a capital asset, includes", only for the purposes of capital assets under the Income Tax Act. An asset included in the stock in trade, as we have seen a short while ago and in view of the specific provisions of Section 2 (14), cannot be included in the scope of the "capital asset". What holds good for transfer of a capital asset, for the purposes of triggering taxability of capital gains, is in the context of a specific legal fiction, which is introduced in the Act for a limited purpose, cannot be treated as omnibus in effect. Learned CIT(A)'s inference about "transfer" of the asset, on the facts of this case, was thus wholly incorrect. He went a step further, by compounding this error, in assuming, entirely based on this misconception about 'transfer', that since it is a case of transfer, it has to be, as he terms it, "consequent sale" as well. When there is no transfer of asset insofar as a business transaction is concerned, there is no question of 'consequences' of such a transfer.

12. Learned Departmental Representative, however, suggests that it does not make a difference because if the profit arising on transfer of land cannot be taxed as capital gains, it can be taxed as a business profit anyway. That is precisely what the learned CIT(A) has held too.

13. We are unable to see any merit in this plea either.

14. The business transaction entered into assessee, in our humble understanding, is this. The assessee has contributed a trade asset consisting of a piece of land, admeasuring 1 acre and 96.22 cents, on which a group housing project by the name of Alexandria was to be constructed, and what he got in consideration of this transfer is the right to sell 1,28,940.26 sq. ft. constructed area in this project. In his closing stock, even if he is to substitute the part ownership of the land transferred with the value of this right to sell 1,28,940.26 square feet constructed area, it would not make any difference to the profit figures because, as far as this assessee, is concerned the cost of acquiring this right is the same as the cost of giving up the right in the hand, and, as is the settled legal position, the closing stock can only be valued at cost price or

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market price-whichever is less. Obviously, the cost price of this right to sell 1,28,940.26 sq ft, which has been treated as a trading asset, is less than the market price of these rights, and, therefore, these rights can only be valued at cost in the accounts.

15. Let us take a pause here and recall the conceptual reasons for valuing the closing stock at cost price or market price whichever is less.

16. In the landmark judgment of **Chainrup Sampatram Vs CIT [(1953) 24 ITR 481 (SC)]**, Hon'ble Supreme Court has observed as follows:

> **........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 at the time of their purchase, 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 have been actual sales in the course of the year showing the profit or loss actually realised on the year's trading. As pointed out in paragraph 8 of the Report of the Committee on Financial Risks attaching to the holding of Trading Stocks, 1919, "As the entry for stock which appears in a trading account is merely intended to cancel the charge for the goods purchased which have not been sold, it should necessarily represent the cost of the goods. If it is more or less than the cost, then the effect is to state the profit on the goods which actually have been sold at the incorrect figure......From this rigid doctrine one exception is very generally recognised on prudential grounds and is now fully sanctioned by custom, viz., the adoption of market value at the date of making up accounts, if that value is less, than cost. It is of course an anticipation of the loss that may be made on those goods in the following year, and may even have the effect, if prices rise again, of attributing to the following year's results a greater amount of profit than the difference between the actual sale price and the actual cost price of the goods in question." (extracted in paragraph 281 of the Report of the Committee on the Taxation of Trading Profits presented to British Parliament in April, 1951). While anticipated loss is thus 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 is to be valued at cost or market price whichever is the lower, and it is now generally accepted as an established rule of commercial practice and accountancy. As profits for income-tax purposes are to be computed in conformity with the ordinary principles of commercial accounting, unless of course, such principles have been superseded or modified by legislative enactments, unrealised profits**

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> **in the shape of appreciated value of goods remaining unsold at the end of an accounting year and carried over to the following year's account in a business that is continuing are not brought into the charge as a matter of practice, though, as already stated, loss due to a fall in price below cost is allowed even if such loss has not been actually realised**.
>
> *(Emphasis, by underlining, supplied by us)*

17. The principle is thus unambiguous. The principles of conservatism, and considerations of prudence, in the accounting treatment require that no anticipated profits be treated as income until the profits are realized, and, at the same time, an anticipated loss to be deducted from commercial profits, at the first sign of its reasonable possibility. Accounting Standard 2, which is a mandatory accounting standard under section 145(2), also states that "**Inventories shall be valued at cost, or net realisable value, whichever is lower**." There may seem to be, at first sight, an element of dichotomy in this approach inasmuch as anticipated losses are taken into account and anticipatory profits are ignored, but that is the impact of accounting principles sanctioned by the statute and the law laid down by Hon'ble Supreme Court.

18. In view of these discussions, the conceptual foundation for this stock valuation principle are accounting principle of conservatism and business considerations of prudence, which have been noticed and approved by Hon'ble Courts above. It is for these reason that when market price of an item in the closing stock is less than its cost price to the business, the notional loss is allowed as a deduction but when market price of an item in the closing stock is more than its cost price to the business, the notional profit is not brought to tax. However, by giving the impugned directions, learned CIT(A) has ended up bringing that anticipated profit to tax.

19. What the assessee has got today is only a right to sell the 1,28,940.26 fts of constructed area in the Alexandria project and the profits, howsoever certain they may appear to be, will only fructify and be realized, and can even be quantified, only when this right is exercised- in part or in full. That stage has not yet come, and until that stage comes, in our considered view, such profit cannot

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be taxed. Unlike in a case of a capital gain which arises on parting the capital asset at the first stage itself, it is a case of business transaction which is completed when the rights so acquired by the assessee are exercised; none can make profits by dealing with himself, as is the settled legal position in the light of the settled legal position in the case of **Sir Kikabhai Premchand Vs CIT [(1953) 24 ITR 506 (SC)].** It is for this reason that we are unable to uphold the action of the authorities below on the facts of this case. No matter how reasonable is it to assume that the assessee will make these profits, these profits cannot be brought to tax at this stage. That is what the legal position, for the detailed reasons set out above, is.

20. In our considered view, therefore, the authorities below indeed erred in bringing to tax the anticipated business profits on assessee's entering into a development agreement with Menorah Realties Pvt Ltd in respect of the land held by the assessee as stock in trade. The impugned addition of Rs Rs.17,28,81,276 is thus deleted.

21. In the result, the appeal is allowed. While outcome of this appeal was pronounced in the open court immediately upon conclusion of hearing and under the signatures of both of us, the reasoned order is pronounced in the open court today on 30th day of June 2015.

Sd/xx
P Madhavi Devi
(Judicial Member)

Sd/xx
Pramod Kumar
(Accountant Member)

Dated: the 30th day of June, 2015.

Copies to:	*(1)*	*The appellant*	*(2)*	*The respondent*
	(3)	*CIT*	*(4)*	*CIT(A)*
	(5)	*DR*	*(6)*	*Guard File*

By order etc

Assistant Registrar
Income Tax Appellate Tribunal
Bangalore benches, Bangalore

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