

A.F.R.

Court No. - 3

Reserved on 08.02.2017

Delivered on 08.03.2017

Case :- INCOME TAX APPEAL No. - 115 of 2010

Appellant :- The Commissioner Of Income Tax-Ii Lko

Respondent :- M/S M.I.Builders Pvt. Ltd. Lko.

Counsel for Appellant :- D.D.Chopra, Manish Mishra

Counsel for Respondent :- Mudit Agarwal, Sri Mudit Agrawal.

Hon'ble Sudhir Agarwal,J.

Hon'ble Ravindra Nath Mishra-II,J.

(Delivered by Hon'ble Sudhir Agarwal,J.)

1. This appeal under Section 260-A of Income Tax Act 1961 (hereinafter referred to as "Act 1961") has been filed by Commissioner of Income Tax, Lucknow (hereinafter referred to as "Revenue") assailing judgment and order dated 08.07.2010 passed by Income Tax Appellate Tribunal, Lucknow Bench, Lucknow (hereinafter referred to as "Tribunal") in Appeal No. I.T.A. No. 170/Luc/2010 for Assessment Year (hereinafter referred to as 'A.Y'.) 2006-07.

2. Appeal was admitted on the following substantial questions of law:-

“(I) Whether it is necessary that revaluation of closing stock routed through profit and loss account and accordingly Assessing Authority had rightly added the amount of rupees one crore in the income of assessee which has been reversed by Appellate Authorities?

(II) Whether any disturbance of closing stock have to be carried out profit and loss account and while reversing the order passed by Assessing Authority, the Appellate Authority and Tribunal committed substantial illegality by not recording finding of each and every issue dealt with by the Assessing Authority?”

3. Facts in brief, necessary for adjudication of the dispute, are as under:-

4. The Assessee is a builder. It filed return of income for A.Y. 2006-07 on 28.11.2006 showing total income of Rs. 39,25,172/-. Pursuant to notice issued under Section 143(2) dated 28.09.2007, Assessee appeared before Deputy Commissioner of Income Tax – Range I Lucknow (hereinafter referred to as “Assessing Authority i.e. A.A.”) and produced books of accounts and other details. Balance sheet tallies at Rs. 1,20,44,000/-. No fresh unsecured loan was taken during the year. Assessee had shown Revaluation Reserve of rupees one crore. Assessee explained this entry stating that it has a plot of land at Quinton Road, Lucknow, which was being disclosed in current assets for the last several years. Value of plot in books was Rs. 3,50,000/- though market value of plot was much more than its book value. Assessee created a revaluation accounts in books and value of plot was enhanced to Rs. 1,00,00,000/- and credited to Revaluation Reserve Account and debited to Quinton Road Plot Account.

5. It was further explained that while finalizing account for Financial Year (hereinafter referred to as ‘F.Y.’) 2005-06, Quinton Road plot, instead of being shown under head Fixed Assets, by mistake was shown under head, current assets along with another land at Bagamau which is part of Assessee’s current stock assets.

6. A.A. found that the aseessee was disclosing all the assets in his closing stock which is a part of work in progress; since last many years. Any disturbance of closing stock have to be carried out through profit and loss account. No amount can be carried to any Reserve account or no reserve can be created without moving through profit and loss account and profit appropriation account. The manner, in which Assessee had shown, was not correct. The fact that revaluation of closing stock was not routed through profit and loss account, and, it had

disturbed balance sheet during the period in question shows an effort to conceal the fact by making such irregularity in balance sheet. Consequently, it added Rs. 1,00,00,000/- as income of Assessee vide assessment order dated 29.12.2008. There are some other additions with which we are not concerned in this appeal.

7. Assessee preferred an appeal before Commissioner of Income Tax (Appeals)-I, Lucknow {hereinafter referred to as 'C.I.T. (A)'}. C.I.T.(A) considered this question in para 3.3 and his findings contained in para Nos. 3.3.2, 3.3.3 and 3.3.4 are reproduced as under:-

“3.3.2. From the above facts, I find that the intention of the appellant company was to transfer the plot of land from its current inventories to the fixed assets account. The only question for consideration is as to whether the act of revaluation of the said plot of land by rupees one crore by passing the contra entry as discussed above leads to any impact on the taxable income of the appellant company. In my view, the revaluation of a fixed asset does not lead to any taxable income for an assessee. It is apparent from the order that it is not the case of the AO that the conversion of current asset to fixed asset is fraudulent; in other words, the AO has not doubted the fact of such conversion. In such circumstances, I am of the view that the above entry has neither reduced the appellant's income of the year, nor has it given rise to any income- 'deemed' or 'real'. It is well settled that an entry in the books of accounts alone is not determinant of an assessee's liability towards tax.

3.3.3. I have, however, given careful consideration to the observations of the AO as contained in the assessment order. I am of the view that to the extent part of the inventory is transferred to the fixed assets A/c, the cost of the same has to be accounted for by the appellant as part of its sales; this is so because a part of the

inventory, instead of being sold to a customer, is being used for captive consumption. I find that the book value of the above plot transferred from its inventory to the fixed assets A/c is Rs. 5,00,750/- which would be considered to be sale to itself and would, accordingly, form part of the appellant's income of the year.

3.3.4. In view of the facts discussed above, out of the total addition of Rs. 1 crore, I am of the considered view that addition to the extent of Rs. 5,00,750/- deserves to be upheld whereas the balance amount i.e. Rs. 94,00,250/- is to be deleted. This ground of appeal is partly allowed.”

8. Thus the appellate authority deleted Rs. 94,00,250/-. Revenue as well as Assessee, both filed appeal to the extent, C.I.T.(A) granted relief to Assessee, and, maintained partial addition, respectively.
9. Revenue's objection regarding deletion of Rs. 94,00,250/- has been considered by Tribunal and its findings in para 9 of the judgement read as under:-

“ 9. We have considered the submissions of both the parties and carefully gone through the material on record. In the instant case, it appears that the assessee was having the plot at Quinton Road, which was shown as Current Assets for several years. However, the assessee wanted to construct an office building on the said plot and accordingly transferred the said plot from the “Current Assets A/c” to the “Fixed Assets A/c” by passing a journal entry. This fact was clarified in the ‘Statement on significant Accounting Policies’ and ‘Notes to the Accounts’ as on 31.3.2007. The AO did not doubt the fact of such conversion and it is also not the case of the AO that the conversion of ‘Current Assets’ to ‘Fixed Assets’ was fraudulent. It is also not the case of the AO that the market value of the said plot was not higher than the book value shown

under the head 'Current Assets in the preceding years. The AO himself made the addition of Rs. 1 Crore considering the market value of the plot in question at Rs. 1 Crore. We, therefore, considering the facts of the present case, are of the view that the market value of the plot was higher than the book value and when the plot was transferred from "Current Assets" to "Fixed Assets", the assessee was justified in taking the value of the plot at market price and since the plot was not transferred or sold to any outsider, the adjustment of the difference in market price and book value was to be adjusted by passing a journal entry. Therefore, in our opinion, the assessee rightly increased the value of the Fixed Assets and the similar amount was credited in the 'Revaluation Reserve A/c'. Now, the question arises as to whether the Id. CIT (A) was justified in sustaining the addition of Rs. 5,00,750 out of the addition of Rs. 1 Crore made by the AO. In the instant case, it is not in dispute that the value of the plot shown under the head 'Current Assets' was Rs. 5,00,750. Therefore, to that extent, the Id. CIT(A) was justified to sustain the addition since the Current Assets were to be reduced by that amount by increasing the income considering the same to be sold to the assessee itself. We, therefore, considering the totality of the facts, are of the view that the Id. CIT(A) was justified in deleting the addition to the extent of Rs. 94,00,250/-. In that view of the matter, we do not see any merit in this ground of the departmental appeal."

10. Cross objection of Assessee against retention of addition of Rs. 5,00,750/- was rejected by Tribunal. Only Revenue has come up in appeal before this court.
11. Shri Manish Mishra learned counsel for Revenue submitted that Assessee has converted stock in trade into capital asset and it can not

move directly to the balance sheet without routing through profit and loss account. The impact of entry is that the Assessee managed to fix cost price of asset in question at Rs. 1,00,00,000/- while paying tax on only Rs. 5,00,750/-. The aforesaid book entry, which deliberately has not been routed through profit and loss account, Assessee would be entitled to claim benefit of lower rate of tax on capital gains vis-a-vis sale of stock in trade and also benefit of inflated cost of acquisition.

12. Where a capital asset is converted into stock in trade; by an Assessee, fair market value of the asset on the date of conversion is deemed to be full value of consideration received/accurring (vide section 45(2) of Income Tax Act 1961). Applying the same principle vice-versa, fair market value of the property has to be adopted even in a case where stock in trade is converted into a capital asset. It was nothing but a colourable device to avoid tax liability. He placed reliance on a constitution Bench Judgment in **Mcdowell and company Ltd. Versus Commercial Tax Officer 1985 (3) SCC 230**.

13. Sri Mudit Agarwal learned counsel appearing for Assessee said that it intended to construct an office building on the said plot. Thus it transferred it into fix assets by making book entries. Since book value of plot was only Rs. 500750/- and market value was much more, therefore to bring lowest value of the plot in the accounts, book value was enhanced to Rs. 1,00,00,000/- and in order to balance account, a cross entry in the account was passed. This entry was passed by debiting ledger account of Quinton Road, Lucknow plot by Rs. 1,00,00,000/- crediting Revaluation Reserve Account by the same amount. The said entry neither reduced Assessee's income of the year nor gave rise to any income, real or imaginary. Purpose was only to reflect correct value of the land in books. An income can be subjected to tax only if it has been received or deemed to have been received, has accrued or is deemed to have accrued. The plot in question was transferred from current assets to

fix assets and return entries were made in the annual year 2006-07. Although transfer was made in F.Y. 2005-06, effect of the entry was given to the balance sheet by Auditors in the opening balance of A.Y. 2007-08. Value of closing stock as on 31.03.2006 in balance sheet of A.Y. 2006-07 was Rs. 15,44,99,424/- and value of closing stock on 31.03.2006 in the balance sheet of A.Y. 2007-08 was Rs. 14,39,98,674/-.

14. He further submitted that effect of above adjustment entry is that Assessee's income in A.Y. 2007-08 stood enhanced to Rs. 1,05,00,750/-. The said income (notional income) was already added in A.Y. 2007-08, addition thereof in A.Y. 2006-07 would amount to double addition.

15. From the rival submissions one thing is clear that there is no income received or accrued to the assessee in any form. Any immovable property which was already subject to disclosure in accounts, its notional value termed as market value was enhanced by Assessee and corresponding entries have been made. In what manner, it will reflect in lower rate of tax in capital gain vis-a-viz sale of stock in trade, we find it difficult to understand, and learned counsel appearing for Revenue also could not explain or demonstrate the same.

16. Tax management which is not contrary to any statutory provision does not constitute tax evasion. Every person is entitled to arrange his affairs to reduce brunt of taxation to the minimum. Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed, is not prohibited. Effectiveness of device depends not upon considerations of morality, but on the operation of Act, 1961.

17. In **Jiyajeerao Cotton Mills Ltd. Versus Commr. Of Income-tax and Excess Profits Tax, Bombay, (1958) 34 ITR 888** it was held that:-

“Every person is entitled so to arrange his affairs as to avoid taxation but the arrangement must be real and genuine and not a sham or make-believe....”.

18. In **Mcdowell and company Ltd. Versus Commercial Tax Officer** (supra) Court said that tax planning may be legitimate provided it is within the framework of law. Colourable devices can not be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay taxes honestly without resorting to subterfuges.

19. On principles, there can not be any quarrel that any attempt by Assessee to avoid tax or in the garb of tax management, enter into sham transaction or entry etc. is not permissible but the question is whether that is a case in hand.

20. Here A.A. has taken a view that re-evaluation of closing stock has to be routed through profit and loss account. It has stated specifically that no amount can be carried to any Reserve account and no Reserve can be created without moving through profit and loss account. This assumption on the part of A.A. is totally misconceived. There is neither such proposition of law recognized, nor any well known accounting system so provides.

21. In **National Hydro Electrical Power Corporation Limited versus C.I.T. (2010), 3 SCC 396**, Court observed that broadly there are two types of reserves:- (i) those that are routed through profit and loss account and (ii) those which are not carried out via profit and loss account. For example a capital reserve such as share premium account.

22. Therefore the basic assumption that every Reserve has to route through profit and loss account, either way is incorrect. Moreover, it is not the case of A.A. that any income has been received or accrued or deemed to have received or accrued. Only transfer of entry was made by Assessee. Unless an income is received or accrued or deemed to accrue, it is not chargeable to tax under Act 1961. There is no finding that this conversion of current asset to fix asset is fraudulent. With respect to

market value of the plot also, since A.A. himself makes an addition of Rs. 1,00,00,000/- therefore value taken by assessee was also acceptable to him. If that be so, Assessee, while transferring entry from current asset to fix asset, reflected market value in the schedule of Fixed assets and similar amount was credited to fix Reserve account. It could not be shown as to how this exercise would have resulted in evasion of tax. There is no receipt or accrual of income nor deemed receipt or deemed accrual of income. In our view, A.A. has assumed a hill when there was not even a mole. That is how A.A. created entire chain of dispute for a small matter of transfer of entry.

23. We are informed by learned counsel for the appellant that there are some accounting standards prescribed by recognized body of Accounting like Institute of Chartered Accountants of India that no amount can be carried to any Reserve account or no Reserve can be created without moving through profit and loss account and profit appropriation account but none such prescribed principles could be shown to us.

24. Process of revaluation of stock by itself can not bring in any real profit as held in **C.I.T. versus K.A.R.K. Firm 1934(2) I.T.R. 183 (SC)** and **C.I.T. versus Hind Construction Limited 1972 (83) I.T.R. 211 (SC)**. Moreover, what is taxable under the income tax law is only real income as held in **C.I.T. versus M/s Shoorji Vallabhdas and Co., 1962 (46) I.T.R. 144 (SC)** and **C.I.T. versus Birla Gwalior (P) Ltd., 1973 (89) I.T.R. 266 (SC)**. Courts have held that there is no principle by which the stock-in-trade can be valued at market price so as to bring to tax the notional profits which might in future be realized as a result of the sale of the stock in trade.

25. C.I.T. and Tribunal have examined the matter and accepted explanation of Assessee that it wanted to construct an office building on the said plot, hence transferred it from Current Assets Account to Fixed Assets Account by passing general entries. Further, as market value of

plot is not much more in books while transferring plot to Fixed Assets, it was enhanced to Rs. 1,00,00,000/- and a cross entry was passed in the consequence.

26. This contrary entry has been passed by debiting Quinton Road plot account and crediting Revaluation Reserve Account. There was some error which was rectified and it was shown to be part of Fixed Schedule and not part of entries. The view taken by C.I.T.(A) that revaluation of Fixed Assets does not lead to any taxable income of an Assessee could not be shown incorrect. The said value has also been accepted by Tribunal. This is findings of facts.

27. The aforesaid approach in our view is neither illegal nor contrary to law nor shown to us to have violated any statutory provision.

28. We therefore answer both substantial questions of law against Revenue and in favour of Assessee.

29. Appeal is accordingly dismissed.

30. No order as to costs.

Order Date :- 8.3.2017

prabhat/Mustaqeem