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IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX REFERENCE NO.268 OF 1997

Mr. Arvind Shamji Chheda ..Applicant.

V/s.

The Commissioner of Income Tax,
Mumbai City X, Mumbai ..Respondent.

Dr.K.Shivram, Senior Advocate with Mr.A.R.Singh & Mr.Rahul R.Sarda for the Applicant.

Mr.Suresh Kumar for Respondent.

CORAM : S.C. DHARMADHIKARI AND A.K. MENON, JJ.

DATED : 12TH SEPTEMBER, 2014

ORAL ORDER (PER A.K. MENON, J.)

1. The present reference is filed under Section 256 of the Income Tax Act, 1961 (the I.T. Act) and it pertains to assessment year 1988-89.

2. The assesse, an individual who was partner in a partnership firm at the material time, had filed an application seeking reference of ten questions. The following two questions have been

since referred to this Court:-

1. Whether on the facts and circumstances of the case, the Tribunal was justified in treating the gains of ₹16,55,508/- on sale of land as business income as against the assesses claim as long-term capital gains ?

2. Whether on the facts and in the circumstances of the case, the Tribunal had any material to come to the conclusion that, land sold by the assesses was stock-in-trade of the dissolved firm, hence assessable business income ?

3. Dr. Shivram, learned Senior Counsel appearing on behalf of the assessee stated that the only question that really requires to be answered is the question No.2. Before dealing with the said question, it would be necessary to advert to few facts.

4. Under a Partnership Deed dated 1st March, 1982, the assessee and one Smt. Amrutben K. Chedda agreed to do business in partnership as builders and contractors in the firm name and style of "Laxmi Construction Co." The profits and losses were to be shared equally. The partnership came into existence on 1st March, 1982 and was at will. The partnership deed is silent as to its assets or the stock-in-trade existing. It transpires that the said partners purchased two plots of land bearing Survey No.14, Hissa No.2 admeasuring 4406 sq.

mtrs. and Survey No.15, Hissa No.2 part admeasuring 8016 sq. mtrs. at village Diwanman, Taluka Vasai, Dist. Thane under a conveyance deed in their favor dated 2nd April, 1982. The partnership firm had agreed to develop the land, however, later decided to dissolve the partnership and a dissolution deed dated 1st April, 1985 came to be executed whereunder the partners decided to treat the partnership assets as their co-owned plots of land and as their personal capital assets.

5. The lands were in their possession and they agreed to take over the plots in their personal capacities as co-owners. Both the parties agreed that they will repay the loan that they had borrowed for the purchase of land out of their own resources. Effective from the date of dissolution I.e. 1st April, 1985, the parties were retaining the land as co-owners of the lands. The rest of the contents of the deed are not relevant for the present purpose.

6. In the assessment order for the period 1988-89, the assessee filed return of income on 29th June, 1988 showing the income of ₹15,49,110/-. He claimed long term capital gains in the sum ₹8,22,754/. The assessing officer recorded that the above two plots were sold by the alleged co-owners on 16th September, 1987 to M/s.

Abhishek Construction Co. for a consideration of ₹37,50,000/- and profit on the sale of these two plots have been claimed by the assesses as well as Smt. Amrutben Chedda as long term capital gains.

7. On behalf of the assessee, it is submitted that the plots of land in question were not stock-in-trade but capital assets. The assessing officer treated the same as business income after providing for deduction of amounts of stamp duty, costs and registration fees and capitalization interest, etc. and arrived at a figure of ₹24,15,540/- which was subject to tax.

8. Being aggrieved by the said order, the assessee filed a appeal before the Commissioner of Income Tax (Appeals) on 25th August, 1989. The Commissioner of Income Tax (Appeals) held that the asset was stock-in-trade and continued to be so till the date of sale dated 16th September, 1987. While dismissing the appeal, the Commissioner of Income Tax (Appeals) proceeded on the basis that the issue under appeal was squarely covered by the decision of this Court in the case of [1]**Khatau Vallabhadas V/s. Commissioner of Income-Tax, Central, Bombay.** The Commissioner of Income Tax (Appeals) observed that it is true that after receipt of the plots, the former partners, including the assessee did not do anything to establish

1 **119 ITR 846**

their intention of exploiting the assets as a commercial asset and there is nothing to indicate that former partners had taken steps to convert the assets into a capital asset.

9. On appeal before the Income Tax Appellate Tribunal, the assessee pursued his case that the plot in question constituted a capital asset in the hands of the partners by virtue of the partnership and its dissolution but held there is no conveyance of the land unto individual members of the partners, although they had been treating the land as personal capital assets and reflected them in their wealth tax returns. The lands were sold after two and a half years of dissolution of the partnership.

10. Mr.Suresh Kumar, learned counsel appearing for the revenue submitted that the land having been sold before three years, therefore, no deduction could be shown even assuming that it was a long term capital gains. It was contended before the Income Tax Appellate Tribunal that whatever the nature of the assets in the hands of the firm after dissolution of the firm, the assets in the hands of the partners was always capital asset and also contended that the other co-owner had already been assessed and her share in the land was treated as long term capital gains as a result, the same treatment was

claimed by the assesses in the present case. The Tribunal found that there was nothing to show that the former partner Smt. Amrutben Chedda had been assessed on the basis of profits as long term capital. The submission that the view taken in the case of co-owner should be adopted in the case of the assesses was rejected. The Tribunal held that in the absence of conveyance of the land in the individual names of the partners, they could not be treated as co-owners and the consequent gains could not be assessed as long term capital gains but as stock-in-trade. The Tribunal was of the view that the lands were brought with the intention to develop and carry out construction as builder and contractor. The character and nature of the land continues to be in the hands of the co-owners as such and constituted stock-in-trade of the partnership firm and the same was the gain from the business income.

11. We have heard Dr.Shivram, learned Senior Counsel appearing on behalf of the Applicant and Mr.Suresh Kumar, learned counsel appearing on behalf of the revenue. Dr.Shivram submitted that when the dissolution took place, the land became the absolute property of two individuals in equal shares which they subsequently disposed of by a single document, namely conveyance executed on 16th September, 1987 in favor of M/s.Abhishek Construction Co. Dr.

Shivram, then, submitted that the gains from the conveyance of the property constituted long term capital gains in view of the fact that the gains were made from sale of capital assets of the firm.

12. It appears that at the time of hearing before the Tribunal certain error crept into the order and a miscellaneous application was filed for correcting it. However, the Tribunal found that there was no mistake in the order but in para 6 of the order of the Tribunal added the words “at the time of framing of the assessment in the instant case” after the words “capital gain”. Dr. Shivram referred to this correction as being evidence of fact that the share of the other co-owner was treated as capital gains in her hands. We are unable to accept this contention. There was nothing to show that the share of the other co-owner was treated as capital gains in her hands.

13. In support of his contention, Dr.Shivram cited the decision of the Honorable Supreme Court in the matter [2]**Addanki Narayanappa & Anr. V/s. Bhaskara Krishnappa (Dead) and thereafter his heirs and others** which relies upon the provisions of the Indian Partnership Act, 1932. In the said judgment, the Apex Court had occasion to deal with sections 14, 15, 29, 32, 37 & 48 of the Partnership Act and consider the nature of interest of partner in partnership property during

2 **A.I.R. 1966 Supreme Court 1300**

subsistence of partnership and after its dissolution. The Apex Court has held that the concept of partnership is to embark upon a joint venture and for that purpose to bring in as capital money or even property including immovable property. Once that is done whatever is brought in would cease to be the exclusive property of the person who brought it in. It would be the trading asset of the partnership in which all the partners would have interest in proportion to their share in the joint venture of the business of partnership. Even the person who brought it in the said property would not be able to claim or exercise any exclusive right over the property which he has brought it. In that case, it was also held that the deed of dissolution under which the partnership is dissolved was not compulsorily registrable

14. Dr.Shivram, then, relied upon the judgment of this Court in Khatau Vallabhdas (supra). The question before the Court was “Whether, on the facts and in the circumstances of the case, the excess realised by the assessee on sale of goods received in respect of his share in the partnership-firm on its dissolution was income, profits or gains from business or constituted capital gains”.

15. While determining the question, the Court observed that it should be borne in mind that grocery articles are not purchased by trader by way of investment to acquire a capital asset, but they are

always purchased as stock-in-trade. They are purchased to be resold as a part of a scheme of profit making. The commodities sold were stock-in-trade of the partnership firm and unless there was something to indicate that the assessee had intended to hold the stock as capital, it would have to be held that the sale of grocery articles was made as part of trading activity.

16. Dr.Shivram, then, relied upon the decision of Gujarat High Court in the case of [3]**Ramjibhai Dahyabhai V/s. Commissioner of Income Tax.** The Gujarat High Court has considered the decision of this Court in Khatau Vallabhdas in which the case under the deed of dissolution of a partnership firm dealing in grocery, the stock-in-trade was divided amongst the partners who agreed to pay the same at cost.

17. As against this, Mr.Suresh Kumar submitted that the property was at all times stock-in-trade of the erstwhile partners of the firm and after the dissolution of the partnership, the partners held the assets and, therefore, there is no question of treating the same capital assets as stock in trade. Even otherwise, the sale had occurred within three years of acquiring the property and even assuming the same to be capital gains, it could not be termed as long term capital gains and it can be treated as short term capital gains.

3 **158 ITR 540**

18. Mr.Suresh Kumar, on the other hand, referred to the question that was framed and referred to this Court in Khatau Vallabhdas (supra) and sought to rely on the observations of the Court that the commodities in question had not changed their character from stock-in-trade to capital goods. In support of his contention, he sought to rely that the issue in the present case was squarely governed by the provisions of the Act and we must however, bear in mind that Khatau Vallabhdas dealt with the grocery stock-in-trade of a perishable nature and, therefore, it is not possible to hold the same as capital assets. On the other hand, the immovable property as in the present case could certainly be traded as a capital asset apart from stock-in-trade to the aforesaid case. The question which arises, therefore, for consideration is two-fold, firstly, whether the property acquired by the two co-owners and or the two partners were stock-in-trade and secondly, if the same were stock-in-trade is their character changed and become capital assets. In this behalf, it is useful to refer to the provisions of the deed of dissolution particularly clause (3) which read as follows:-

> "3. The parties hereby declare that they have agreed to take over two plots of land as co-owners and will have absolute possession of the said plots as their capital assets, and shall

> have co-ownership interest in the said plots in equal proportion. Both the parties hereby agreed that they will repay the loans which they have borrowed for the purchase of plots out of their own resources or borrowing on their personal accounts. They also agreed to pay of the creditors and discharge other liabilities."

19. As can be seen from the above clause, the erstwhile partners agreed to take over the two plots of land as co-owners and claim possession of the plots as their personal assets. It is also pertinent to note the fact that in the recitals of the deed of dissolution, the following portion is of relevance.

> " … AND WHEREAS the Partnership had purchased two plots of land (1) bearing survey No.14, Hissa No.3, admeasuring 8016 sq.mts. and survey No.15, Hissa No.2 (Part) admeasuring 4406 sq.mts. at village Diwanman Taluka, Vasai, Dist. Thane as per conveyance deeds executed with vendors on 2nd April, 1982... "

> "... AND WHEREAS the parties hereto have now decided to convert the partnership assets i.e. individual co-ownership 2 plots of land as their personal capital assets...."

From the recitals which precede clause (3), it is clear that at the material time i.e, the parties treated two plots of land as stock-in-trade and it is only at the time of dissolution, they agreed to convert the

partnership assets i.e. having co-ownership of the two plots into a personal capital asset. The property in the hands of the partners, therefore, did undergo change in nature by way of conversion of property into capital assets from its earlier nature of partnership property. Thus, in terms of the judgment of Khatau Vallabhdas (supra), the property did undergo a change in its nature and, therefore, became eligible for being treated as capital asset subject to all other applicable provisions of law. In this respect, the fact of non registration need not engage our attention in view of the judgment of the Apex Court in Addanki Narayanappa & Ors. (supra).

20. Dr.Shivram also relied upon the judgment of Mysore High Court in [4]**K.T. Appanna V/s**. **Commissioner of Income-Tax, Mysore** wherein the Court considered the issue of a partner who sold lands that fell to his share upon dissolution and whether it constituted profits of business and whether an inference could be drawn that his partnership business continued. The present case is not a case where after dissolution of the partnership, the assessee had purchased another land and the fact that the assessee has sold the land that fell to his share at the time of dissolution of partnership, did not justify drawing an inference that he wanted to continue on his own in the business of the erstwhile partnership of which he was a member. Having observed thus

4 **LXIV I.T.R. 310**

the Court found that no conclusion can be drawn that the sale in question by the partnership was effected in the course of business. The Court, then, held that sums earned out of the transaction were revenue profits chargeable to tax.

21. In the present case, however, there is nothing to show that the assessee as also the erstwhile Smt. Amrutben Chheda had dissolved the firm with the intention to carry on the said business of the firm in their individual capacities. The assessee and the former partner sold the land to a third party. They did not carry on the business of M/s. Laxmi Construction Co., the partnership firm i.e. of builders and/or contractors. It is not the case of the revenue that the business of the firm was that of buying and selling land and that being the case, it would have been possible to contend that the sale of the land by erstwhile partners constituted business of the partnership in their individual capacity and for that reason could brought within the fold of stock-in-trade. However, in the case at hand, the land was simplicitor sold to a third party who incidently might have been in the business of construction. However, that is not a factor that is relevant for the purpose of the present reference.

22. Dr.Shivram then relied upon the decision of this Court in the matter of [5]**P.H.Hamid V/s. Commissioner of Income-Tax** wherein

5 **278 ITR 112**

certain assets of the erstwhile firm were allowed depreciation and were sold to the assessee upon dissolution of the firm. The assessee sold the assets and invested the sale proceeds in specified assets. It was held in that case that the amount of depreciation availed of by the erstwhile firm, was not liable to be brought to tax in the hands of the assessee.

23. The next judgment relied upon by Dr.Shivram is [6]**Gulabrai Hanumanbox V/s. Commissioner of Wealth Tax** in which the facts pertain to the house property jointly held in equal shares by the assessee and other co-owner for the assessment year in question. In the assessment order, the report of the valuer of the assessee was accepted and the share of the half property in the case of co-sharer was taken for a particular amount. The assessee in question then sought the same benefit as given to the co-owner. In that case, we find that the transaction of the co-sharer was entitled to the benefit, then the assessee will be similarly placed and it would be highly improper to burden a co-sharer with higher rate of tax and if such an action is sanctioned, it would militate against the principles of equality of laws enshrined in article 14 of the Constitution. This in our view, is not relevant in the present case since there is no evidence that the co-sharer was given the benefit of long term capital gains and, therefore,

6 **198 ITR 131**

was relied to record the extent of fact.

24. Notwithstanding this we are of the view that the question before us is, whether in the facts of the case, there was any material on record to come to the conclusion that the land sold by the applicant was stock-in-trade. In our view, the correct test to be applied is whether the partnership assets were converted to capital assets of the partners at the time of dissolution. This we find, was provided for in the dissolution deed itself which records in clause (3) that the parties have agreed to take over the plots of land as co-owners and as capital assets and they shall have co-ownership and as a test of conversion if applied, the assessee has indeed provided for conversion. Hence we have no difficulty in concluding that the property does not seem to be stock-in-trade by the execution of the dissolution deed. In our view, there is no mode which provides for conversion of stock-in-trade into capital assets except by agreement of parties.

25. In the instant case, the deed of dissolution achieves that objective. In the case of Khatau Valabhdas, the Court was concerned with the division of stock-in-trade i.e. grocery products. In the present case, the business of the partnership was of builders / contractors and not of buying and selling the land and the partners at the material time were not engaged in any construction activity and no such construction

was being carried out on the land. A building was to be put up on the land purchased by the erstwhile partnership firm but the land remained vacant and nothing is done on the land or to the land so as to show it as stock-in-trade and not treat it as capital assets share of the assessee.

26. In the circumstances, we answer both the questions in the negative and hold in favour of the assessee and against the revenue. We hold that the Tribunal had no material to come to the conclusion that the land sold by the applicant / assessee was stock-in-trade and the Tribunal was not justified to treat the same as business income. However, we leave open the question whether the amount in the hands of the applicant / assessee is to be treated as long term capital gains or short term capital gains to be decided by the department.

27. The reference is, therefore, accordingly answered. No order as to costs.

(**A.K. MENON**, J.) (**S.C.DHARMADHIKARI, J.**.)