
(2000) 02 BOM CK 0029
In the Bombay High Court
Case No : Income-tax Appeal No. 180 of 2000

Commissioner of Income Tax	Vs	APPELLANT
Associated Builders		RESPONDENT

Date of Decision : 28-02-2000

Acts Referred:

Income Tax Act, 1961 — Section 260A, 263

Citation : (2001) 249 ITR 701 : (2001) 115 TAXMAN 19

Hon'ble Judges : S.H. Kapadia, J;A.P. Shah, J

Bench : Division Bench

Advocate : R.V. Desai and J.P. Deodhar, for the Appellant; F.A. Irani, for the Respondent

Judgement

1. The assessee-firm was in the business of selling flats. The firm stood dissolved on June 30, 1986. Prior to the date of dissolution, the flat in question was used by the firm as an office. It was on the ground floor of the building. It had remained unsold till the time of dissolution. The dissolution was pursuant to a family arrangement dated July 11, 1986. The firm stood dissolved by mutual consent. Under the dissolution, three out of four partners retired except Smt. Sufia Suleman who was to continue the partnership business. All the partners belong to the same family. The continuing partner agreed to continue the business from July 1, 1986. For the assessment year 1987-88, return of income was filed by the dissolved firm. Since the assessee was in the business of selling flats, the Assessing Officer treated the office premises as stock-in-trade. The Assessing Officer took the last sale transaction into account as on July 15, 1985, at the rate of Rs. 252 per sq. ft. and, on the assumption that the property prices had increased between July 15, 1985, and June 30, 1986, adopted the rate of Rs. 400 per sq. ft. As stated hereinabove, without considering the factual position, the Assessing Officer treated the office premises as stock-in-trade and on that basis, he concluded that the income on the said transaction of the stock-in-trade having accrued to the continuing partner in the sum of Rs. 1,42,290, he made the said addition. Accordingly, the Assessing Officer taxed the notional

profit of Rs. 1,42,290. Being aggrieved, the assessee preferred an appeal to the Commissioner of Income Tax (Appeals). The appellate authority, on the facts, found that the flat in question was used by the firm as office prior to the dissolution. That, even after dissolution, it continued to be used as office by the continuing partner. Applying the ratio of the judgment of the Supreme Court in the case of Commissioner of Income Tax Vs. Kikabhai Premchand, , the appellate authority ordered deletion of the said amount of Rs. 1,42,290. The appellate authority, on the facts, found that the flat was never meant for sale. That, under the family arrangement, the partners agreed to settle their claims in the firm by taking the value of the office premises at cost price as the said premises were never intended to be sold in the market. Being aggrieved by the decision of the Commissioner of Income Tax (Appeals), the Department went in appeal on the above point to the Tribunal. Before the Tribunal, it was urged by the Revenue that the said office premises should be treated as stock-in-trade and, accordingly, the flat should be valued at the price it would fetch in the open market. It was contended by the Revenue that the flat was never held as a capital asset. That, the assessee had never claimed any depreciation on the said flat. That the expenses on the construction of the flat were debited to the profit and loss account and, therefore, mere user of the flat by the firm for office purposes would not make the flat a capital asset. Reliance was placed by the Revenue on the judgment of the Supreme Court in the case of A.L.A. Firm Vs. Commissioner of Income Tax, Madras, . On behalf of the assessee, it was urged on the other hand that the said flat was a capital asset as indicated by the balance-sheet which clearly described the flat on the assets side at book value, viz., Rs. 46,710. It was contended on behalf of the assessee that the judgment of the Supreme Court in A.L.A. Firm Vs. Commissioner of Income Tax, Madras, had no application to capital assets. In the alternative, it was contended on behalf of the assessee that in any event, even assuming that the flat constituted the firm's stock-in-trade, it was still required to be valued at cost price in view of the family arrangement between the partners which made it clear that the flat shall be used only for office purposes by the continuing partner. It was contended that even in the case of A.L.A. Firm Vs. Commissioner of Income Tax, Madras, , it is laid down that on dissolution of the firm, the stock-in-trade must be valued at market price. However, this commercial accounting principle was subject to the contract between the partners to the contrary. On the facts, the Tribunal accepted the findings given by the Commissioner of Income Tax (Appeals). The Tribunal held that it was a well settled proposition that while the firm is continuing, the closing stock can be valued either at cost or at market price, whichever is lower. However, on dissolution, the assets must be valued by adopting the market rate of the closing stock, subject to the contract to the contrary. The Tribunal held that in the case of A.L.A. Firm Vs. Commissioner of Income Tax, Madras, , there was no contract to the contrary which is the case in the present matter. The Tribunal further held that there was no legal principle which laid down that in all cases the stock-in-trade, on dissolution, shall be valued only at market price. The Tribunal distinguished the facts of the present

case from the facts in the case of A.L.A. Firm Vs. Commissioner of Income Tax, Madras, . Reading the family arrangement, the Tribunal found, on the facts, that the partners had categorically agreed to dissolve the firm on the basis of the book value. That the accounts, inter se, between the parties were agreed to be settled upon on that basis. That, the office premises were never intended to be sold. That, whether the flat is treated as a capital asset or a stock-in-trade was immaterial inasmuch as on the date of dissolution, all assets were required to be valued on the basis of the market value, subject to the contract to the contrary. Hence, the Tribunal upheld the order of the Commissioner of Income Tax (Appeals). Being aggrieved, the Department has come in appeal u/s 260A of the Income Tax Act, 1961.

2. At the outset, it may be mentioned that, although on the facts we agree with the Tribunal, we are of the view that the reasoning given by the Tribunal contains propositions which are very wide and, therefore, we are required to give our own reasons for dismissing this appeal. In this matter, the Assessing Officer found that the assessee-firm was in the business of selling flats. It is not in dispute that the said flat has been used as office before the date of dissolution and even thereafter. The facts found by the authorities below show that the flat has remained unsold. In the circumstances, the basic question which arises in this case is : whether the Assessing Officer was right in adopting the value of the unsold flat at the rate of Rs. 400 per sq. ft. The Assessing Officer in that regard takes into account the transaction dated July 15, 1985, of the sale of a flat sold by the firm as a stock-in-trade and then, without ascertaining as to whether Rs. 400 per sq. ft. is the fair value of the flat, arrives at the said figure of Rs. 400 per sq. ft. by multiplying the transactional value of the flat sold in 1985 as a stock-in-trade. This aspect is of some importance. The various authorities referred to hereinafter show that in the cases of dissolution of the firm, all assets must be taken at a fair value. That, it is true that as a general rule, all assets must be taken at the market value. However, if there is a contrary agreement by which the partners inter se agree to settle their claim in the firm by taking" the value of an asset at cost price, the Assessing Officer must ascertain on the facts and in terms of such an agreement as to whether the book value represents the fair value of the property. By way of illustration, at present, the property market is in a doldrums. There could be cases where the book value may reflect the fair value of the property. However, where the assessee relies upon the agreement to the contrary, the Assessing Officer must examine all the facts and come to the conclusion as to whether the value of a particular asset on the date of the dissolution as mentioned in the agreement, is the fair value of the property or not. In the case of A.L.A. Firm Vs. Commissioner of Income Tax, Madras, , the apex court has laid down that in the cases of dissolution of the firm, the valuation of the stock-in-hand on the date of the dissolution should be on the basis of the prevailing" market value. In the said judgment, the Supreme Court has relied upon a passage from Pickles on Accountancy in which it has been observed that in the absence of a contrary agreement, all assets and

liabilities must be taken at fair value and not merely at book value. This passage has been used by the Tribunal in the impugned order. The judgment of the Supreme Court in the case of A.L.A. Firm Vs. Commissioner of Income Tax, Madras, did not deal with the valuation of a capital asset. However, the above passage, from Pickles finds place in the book Pickles on Accountancy and under the Chapter of Dissolution of Firms, it is clearly laid down that all assets, on dissolution, must be taken at fair value. It is, therefore, true that this principle will apply to stock-in-trade as well as capital assets. However, as stated hereinabove, the Department, without ascertaining the fair value of the flat has, without any basis, adopted Rs. 400 per sq. ft. This valuation is arbitrary. On the facts, it is clear that the flat was not intended to be sold. If that be the case, the Department should have examined whether the fair value of the flat was Rs. 400 per sq. ft. It could not have relied upon the last transaction of July 15, 1985, which dealt with stock-in-trade. The appellate authority and the Tribunal have deleted the addition for a different reason, viz., that there was an agreement to the contrary and, therefore, the book value could be taken into account. We do not agree to that extent with the reasoning of the Tribunal. On the dissolution, an asset, be it a current asset or a fixed asset, is required to be valued at a fair value and not merely at a book value. However, in cases where the assessee relies upon a contrary agreement to value the asset at cost price, the Department must allege that the book value does not represent the fair value. On examining the facts including the agreement, if the Assessing Officer comes to the conclusion that the book value does not represent the fair value, then on the basis of the sales statistics or any other evidence, the Assessing Officer can certainly come to the conclusion that the contrary agreement does not indicate the real value of the property in which event the contrary agreement will not bind the Department. In the present matter, the Tribunal has laid down a very broad statement of law that in the event of there being in existence a contrary agreement, all assets must be taken at book value. If this statement is accepted, it would be open to the parties to enter into contrary agreements on paper and evade taxes by declaring the value of the asset on the basis of the cost price. In the case of Commissioner of Income Tax, A.P.-I Vs. Agarwal Enterprises, , the Andhra Pradesh High Court has laid down that, according to the commercial accounting principles, the true test is as to what is the fair value of the asset. That, it is for the Assessing Officer to ascertain the fair value of the asset. That the correct value may be either the market price or the cost price. In that matter, on the facts, the Commissioner of Income Tax initiated proceedings u/s 263 of the Income Tax Act on the ground that the order passed by the Assessing Officer was prejudicial to the Revenue. According to the Commissioner of Income Tax, the immovable property was a stock-in-trade as the business of the assessee was to deal in real estate. The Commissioner of Income Tax set aside the order of the Assessing Officer on the ground of undervaluation. After referring to the judgments referred to hereinabove, the High Court took the view, with respect rightly so, that the Department under the Act has to ascertain the fair value of the asset and if it comes to the conclusion that the book value does not

correspond to the fair value, then the Department will not be bound to accept the book value. Therefore, the High Court set aside the order of the Commissioner of Income Tax on the ground that he had taken ad hoc figures in arriving at the real income. The said judgment applies to the facts of this case. As stated hereinabove, the Assessing Officer has taken ad hoc figures for arriving at the additions which he has made on the basis that the earlier flat sold was a stock-in-trade. In fact, on the facts of this case, it is clear that the flat was used as an office before and after dissolution. That the partners agreed to settle on the basis of the flat not being permitted to be sold. On the facts, the Commissioner of Income Tax (Appeals) and the Tribunal have come to the conclusion that there was an agreement to the contrary. On the facts, there is nothing to indicate that the Department has impugned the family arrangement. Therefore, it is clear that the flat in question was not intended to be sold and if that be the case, then the Assessing Officer ought to have ascertained the fair value of the flat. In other words, the market value arrived at by the Assessing Officer was on an arbitrary basis. The Commissioner of Income Tax (Appeals) has relied upon the judgment of the Supreme Court in the case of Commissioner of Income Tax Vs. Kikabhai Premchand, . In that matter, the assessee was a dealer in silver and shares. He was the sole owner of the business. He maintained his accounts according to the mercantile system. He valued his stock at cost price, both at the beginning and at the end of the year. During the relevant year of account, the assessee withdrew some stock of shares and silver bars from the business and settled them on certain trusts in which he was the managing trustee. In the books of account of the assessee, the business was credited with the cost price of the silver bars and shares so withdrawn. The Assessing Officer held that the assessee derived income from the stock-in-trade thus transferred and accordingly assessed him on a certain sum being the difference between the cost price of the stocks and the market value on the date of their withdrawal from business. The Supreme Court ordered deletion of the additions made by the Department on the ground that the above transactions were not business transactions. The facts of the said judgment have no application to the present case. The Commissioner of Income Tax (Appeals) erred in coming to the conclusion that the said judgment applies to the facts of this case. Commissioner of Income Tax Vs. Kikabhai Premchand, judgment was delivered in the context of withdrawal of the assets from the business of a sole proprietary concern. It was not a case of dissolution of a partnership firm. In fact, at page 512, the Supreme Court itself has clarified that they did not wish to express any opinion on the cases of dissolution of partnership. In the circumstances, the judgment of the Supreme Court in Commissioner of Income Tax Vs. Kikabhai Premchand, will not apply to the facts of the present case. On the other hand, in the case of Commissioner of Income Tax Vs. Bharath Auto Stores, , the Madras High Court was concerned with a case in which there was a clause in the partnership deed to the effect that on dissolution, the assets of the firm, including the stock-in-hand, shall be valued at book value and divided amongst the partners. By a deed of dissolution, the firm was dissolved and subsequently, each partner took over the businesses. In that

matter, the partnership carried on the business at two different places under two different names. For the concerned assessment year, the firm valued the closing stock at book value. The Assessing Officer valued the closing stock on the basis of the market value. The Tribunal took the view that the rights of the parties would be governed by the clause in the deed of partnership referred to above and hence the assets were ordered to be valued on the basis of the book value in accordance with the deed of partnership. The High Court rightly held that though under the partnership deed, the parties agreed that, in the event of dissolution, the book value should be adopted, such an agreement may be good only as between the partners. However, such an agreement was not binding on the Revenue. In that matter, the facts show that the Assessing Officer valued the stock on the basis of the market value after taking into account all the facts and circumstances of that case and coming to the conclusion that the book value did not represent the fair value. In the circumstances, the High Court held that on dissolution, the Department was right in valuing the stock on the basis of the market price. In other words, there could be an agreement to the contrary. Such an agreement, however, will not bind the Department. However, the Department must come to the conclusion on the facts that the contra agreement produced by the assessee did not indicate the fair value. Before concluding, it may also be mentioned that the judgment of the Supreme Court in the case of A.L.A. Firm Vs. Commissioner of Income Tax, Madras, dealt with the question of revaluation of the assets.

3. To sum up, the following principles emerge from the above discussion.

(a) That all assets (including stock) have to be valued at the time of dissolution of the firm at the fair value.

(b) In cases where the assessee claims, as in the present case, that the valuation is done on the basis of the book value under a contract to the contrary, the Assessing Officer must ascertain whether the valuation of the assets made by the assessee under such a contract represents the fair value/ market value and if the Assessing Officer comes to the conclusion that it does not represent the fair value, then the Assessing Officer would be entitled to say that such contra agreement will not bind the Department. In other words, on dissolution, all assets must be taken at the fair value.

(c) We respectfully agree with the view of the Madras High Court in Commissioner of Income Tax Vs. Bharath Auto Stores, and also with the view of the Andhra Pradesh High Court in the case of Commissioner of Income Tax, A.P.-I Vs. Agarwal Enterprises, .

4. Applying the above principles to the facts of the case in the present matter, as stated above the Commissioner of Income Tax (Appeals) as well as the Tribunal have recorded a concurrent finding of fact that the partnership firm was a family concern ; that the flat in question was used as office prior to the dissolution ; that it continued to be office after dissolution ; that the flat was not to be sold

and that the valuation done by the Assessing Officer was arbitrary. We do not wish to interfere with the finding of fact. As stated above, we do not agree with the broad propositions referred to in the judgment of the Tribunal. We have given detail reasons so that the law stands clarified. We may also mention that if the judgment of the Tribunal is read as a whole, it would be open to the partners to enter into an agreement whereby assets could be undervalued on the ground of contra agreement referred to above. Ultimately, the fair value concept will depend on the facts of each case as stated above. Subject to above, the appeal stands dismissed.