**IN THE INCOME TAX APPELLATE TRIBUNAL**
**MUMBAI BENCH "A", MUMBAI**

**BEFORE SHRI R.C. SHARMA, ACCOUNTANT MEMBER**
**AND SHRI AMIT SHUKLA, JUDICIAL MEMBER**

**ITA NO. 3866/MUM/2011 : (A.Y : 2007-08)**

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| Asst. Commissioner of Income Tax - 16(1), Mumbai | Vs. | M/s. Kothari Development Corporation, 35, Samrat Ashok Building, R.R. Thakkar Marg, 7, Malabar Hill, Mumbai 400006 **PAN : AAGFK9285R** |
| (Appellant) | | (Respondent) |

**ITA NOS. 3084/MUM/2011 & 5721/MUM/2013 & CO NO. 14/MUM/2012 (Out of ITA NO. 3866/MUM/2011) : (A.Y : 2007-08)**

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| M/s. Kothari Development Corporation, 35, Samrat Ashok Building, R.R. Thakkar Marg, 7, Malabar Hill, Mumbai 400006 **PAN : AAGFK9285R** | Vs. | Asst. Commissioner of Income Tax - 16(1), Mumbai |
| (Appellant) | | (Respondent) |

**Assessee by : Shri Vimal Punmiya**
**Revenue by : Shri Aarsi Prasad**

**Date of Hearing : 17/02/2016**
**Date of Pronouncement : 31/03/2016**

**O R D E R**

**PER R.C. SHARMA, AM** :

These are cross-appeals being ITA No. 3084/Mum/2011 & 3866/Mum/2011 filed by the assessee and revenue respectively and cross objection being CO No. 14/Mum/2012 by the assessee against the order of CIT(A)-27, Mumbai for A.Y 2007-08, in the matter of order passed u/s 143(3) of the Income Tax Act, 1961.

2. Rival contentions have been heard and record perused. Facts in brief are that the assessee was owner of the plot located at survey No. 895, Turner Road, Bandra, Mumbai (impugned property) which was converted from capital asset to stock in trade on 18-2-2006. The said property was sold during the year under consideration giving rise to capital gains as well business profits. The impugned property was originally owned by one Mr.Percy Maurice Pereira (here in after called vendor) and was in his possession and enjoyment. The assessee entered into an agreement for purchase of the impugned property with the vendor vide agreement dated 7-8-1973. As on the date of agreement the impugned property was subject matter of suit No. 376 of 1970 filed by the brother of the vendor before the High court, which fact was acknowledged by both the parties in the preamble to the said agreement. The impugned property was agreed to be purchased for a sale consideration of Rs 2.5 Iakhs and an amount of Rs.10000 thereof was paid to the vendor on the date of agreement itself. The title deeds were examined by the purchaser/assessee and apparently due to the suit pending before the High court the property could not be conveyed

to the purchaser/assessee. Nevertheless both parties continued to hold the impugned agreement and vide the vendor's letter dated 14-5-1976, the vendor confirmed that the time for completion of the sale was extended until such time the suit was finalized or settled in favour of the vendor. That apart the assessee paid monies to the vendor from time to time, being the sale consideration, as requested by the vendor and the total amount paid in this regard was Rs.21950 including the amount of Rs.10000 paid at the time of execution of the agreement. Further the assessee also made an attempt to help the vendor to defend the suit in favour of the vendor. Thereafter, the purchaser/assessee having learnt that the vendor was contemplating to settle the suit in a manner that will prejudice the rights of the purchaser/assessee, called upon the vendor to perform the contract within seven days from the receipt of the notice vide their letter dated 10-4-1980. Having not received any reply from the vendor in this regard, the assessee, i.e., the purchaser filed Suit no.889 of 1980 before the High court stating that there is a valid and subsisting agreement in respect of the impugned property in favour of the assessee and the vendor has no right, title or interest in the said property owing to the said agreement. The assessee also stated that at all material points of time prior to the filing of the suit and at the time of filing the suit the assessee was ready and willing to perform their part of the agreement for sale. In view of these facts, the assessee requested the court to declare that there is a valid agreement as above and to order and decree the vendor to specifically perform the agreement and to do all acts to convey the impugned property in favour of the assessee. In the meanwhile, Suit No. 376 between the vendor and his brother was settled vide consent terms dated 29-7-1981 and it was agreed therein that vendor was absolute owner of the impugned property and the vendor's brother has no right in it. The assessee having come to know about the said settlement during first week of February 1982 only, immediately moved the High court vide their petition dated 10-2-1982 to restrain the vendor by an order of injunction from dealing with, disposing of, alienating, encumbering or leasing out or creating any right in favour of a third party or parting with the possession of the suit property, with an intention to protect and preserve assessee's, right and interest therein. The High court passed the injunction orders as requested by the assessee vide their orders dated 24-1-1983. Further the assessee got the impugned sale agreement registered in his favour on 29-8-1986 by presenting it before the Sub Registrar. Thereafter the Suit was pending for adjudication before the High court for a long time which was finally decided by the consent terms of the Suit parties dated 21-12-2005 filed before the High court. Finally the High court passed decree in favour of the assessee holding that there is a valid and subsistent agreement and the vendor was directed to do all acts so as to effectively convey the property to the assessee. Further the assessee was also directed to pay an amount of Rs. 1.6 crores in addition to the amounts already paid to the vendor and the decree was to operate as conveyance of the property on payment of the said amount. Accordingly, the payments were made to the vendor and the conveyance deed was executed on 20-2-2006. In the above background the assessee converted the said impugned property into his stock in trade in February 2006 and sold the same in the following financial year relevant to the A.Y. under consideration. On completion of the sale, the assessee computed capital gains up to February 2006 and business profits for the period thereafter. The capital gains were offered to tax for the A.Y. under consideration following the provisions of Sec. 45(2) of the Act. In computing the capital gains, the assessee adopted the FMV of the impugned property on 1-4-81 as it's cost of acquisition on the ground that the right title in the property was available to them since 1973 owing to the subsistence of the above discussed agreement. That apart the assessee also paid an amount of Rs.54 lakhs to one of it's retiring partner Smt. Sushila Kothari, owing to the deed of retirement of partnership dated 21-12-2005. The assessee claimed that the said amount was paid to her as compensation to remove the encumbrance on the impugned property that she was creating hurdles to dispose of the property and therefore the payment of Rs. 54 lakhs should be treated as expenditure incurred in relation to the transfer of the impugned property and it would go to reduce the taxable capital gains arising on sale of the impugned property. As against the above claim of the assessee, the A.O. held that the rights in the impugned property passed on to the assessee only on account of the consent terms filed before the High court and the consequent decree passed by the High court directing the vendor to convey the property. In this regard the A.O. observed that even though there was a valid and subsisting agreement with the vendor in respect of the impugned property, the sale took place only on payment of the amount agreed upon in the consent terms to the vendor and handing over the possession of the property to the assessee by executing the conveyance deed by the vendor. The A.O. further noted that the agreement of sale is neither decisive nor conclusive as to the date of sale and the injunction order passed by the High court restraining the vendor from alienating the property is no evidence to establish the rights of the assessee in the impugned property. Further the A.O. also stated that the\fact of registering the sale agreement with the Sub Registrar is also not indicative of establishing the appellant's rights therein by observing that the title of the property is transferred on execution/performance of the contract and not by mere registration of sale deed. In essence, the A.O. held that the assessee owned the property only in F.Y. relevant to A.Y.2006-07 and therefore the asset was owned by him for a period of less than 36 months as on the date of it's transfer by the assessee and therefore the capital gains arising from the impugned transaction are to be taxed as short term capital gains. As a consequence the A.O. also disallowed appellant's claim for deduction u/s 54 EC of the Act towards investment in specified bonds. The AO also declined payment of Rs. 54 lakhs made to clear such encumbrance but for which the sale could not have taken place and accordingly disallowed the assessee's claim to deduct the same from taxable capital gains.

3. By the impugned order, CIT(A) allowed assessee's claim of long term capital gains, however, he declined payment of Rs. 54 lakhs made to remove the encumbrance.

4. Against the above order of the CIT(A), both assessee and revenue are in appeal before us and assessee has also filed cross-objection.

5. We have considered the rival contentions carefully and gone through the orders of the authorities below and find from the record

that assessee sold one property during the year and offered long term capital gain after claiming exemption u/s 54EC and claimed deduction of Rs. 54,00,000/- on account of compensation for encumbrance but the AO held that asset is short term capital asset. Hence, exemption u/s 54EC will not be allowed. The AO also disallowed the claim of compensation for encumbrance. The CIT(A) held that asset is long term capital gains and date of acquisition is 19.7.1981 instead of 9.7.1973 claimed by the assessee. Therefore, fair market value of 1.4.1981 will not be allowed, but confirmed the addition of Rs. 54,00,000/-. We find that as per agreement of sale deed executed on 7.3.1973 which has been duly registered with the Sub-registrar of Assurance, Mumbai under S-2489/82 in the name of the assessee, the assessee has acquired right in the property from the date of agreement to sale dt. 7.3.1973. We also find that on 24.1.1983 assessee obtained an order and injunction against the vendor preventing the vendor from alienating, encumbering, transferring parting with the possession of the suit property. The order of the Hon'ble Court clearly evidences that the court accepted assessee's claim, right title and interest in the property conferred upon vide agreement dated 1973.

6. In view of the above, it is clear that right of assessee in the property is existed since from 1973. Clause 2(a) of Consent Term in the Suit no. 889 of 1980 before Hon'ble Bombay High Court also clarifies that agreement of 1973 was valid.

7. Accordingly, we do not find any infirmity in the action of CIT(A) for treating capital gains as long term capital gains. However, he has

allowed indexation from 19.7.1981 in place of date of acquisition of property in the year 1973. Since the property was acquired vide agreement of sale deed executed on 7.3.1973 which was duly registered with the Sub-registrar, we direct the AO to allow indexation by taking fair market value as on 1.4.1981. As per Sec. 2(29A) and 2(42A) holding period will be counted from the date from which assessee held the asset i.e. when right in capital asset was vested to assessee which is from the date of allotment or agreement for sale. It does not require that property should be conveyed. Even if the land was purchased, but not conveyed in the name of the assessee it will not affect the holding period of asset. Our view is duly supported by the decisions of the Hon'ble Punjab & Haryana High Court in the case of *Madhukaul (43 taxmann.com 417)* and *Vinod Kumar Jain (344 ITR 501)*. As the property was acquired before 1.4.1981, we direct the AO to take fair market value of property as on 1.4.1981 as per provisions of Sec. 55(2) of Income Tax Act for the purpose of indexation while computing long term capital gains.

8. With regard to declining assessee’s claim of payment for removal of encumbrances amounting to Rs. 54 lakhs, we find that one Partner, Smt. Sushila Devi created problems for the on issue of property. Therefore, vide Deed of Retirement of Partnership dt. 21.12.2005, assessee resolved the problem by paying Rs. 54 lakhs in addition to her capital in the firm for the settlement of her claims in the capital as per clause no. 2 on page no. 3 of Deed of Retirement of Partnership dt. 21.12.2005, profits and assets of partnership firm which comprised the property at Bandra as only property.

9. As per Sec. 48 if the expenditure is incurred wholly and exclusively in connection with transfer of capital asset, in that situation expenditure is allowable. The above condition is satisfied in present case because one can sell the property only when the property is free from encumbrance. In the instant case, in a firm, if any partner disagrees to sell the property, the firm cannot sell the property which it is intending to sell. In other words, if any partner does not agree to sell for any reasons, then, there is an encumbrance for selling the property. To sort out such a problem and to make property, which is intended to be sold, without any encumbrance, it is necessary to settle the difference between the partners by either convincing the partner for selling the property or to retire the said partner by paying his dues and claim. Thus, the assessee firm in order to clear the encumbrance on property has paid Smt. Sushila Devi Rs. 54 lakhs in addition to credit balance in her capital. Only after that assessee been able to file the consent term before the Hon'ble High Court on same day i.e. 21.12.2005. otherwise neither consent term will be filed nor assessee before court gets the property conveyance. Hence, it is paid wholly and exclusively for the purpose of sale of capital asset.

10. In view of the above, there is no justification in the order of lower authorities for enhancing capital gains by not allowing deduction of Rs.54 lakhs paid to partner to remove encumbrance.

11. In the result, appeal of revenue is dismissed, whereas appeal of assessee and cross-objection is allowed in part.

**ITA No. 5721/Mum/2013 :**

12. This is an appeal filed against the order of CIT(A), in the matter of imposition of penalty u/s 271(1)(c) of the Act.

13. We have considered the rival contentions and find that penalty has been imposed for declining payment of Rs. 54 lakhs claimed as expenses for removal of encumbrance. As we have already allowed assessee's quantum appeal on this issue as discussed in ITA No. 3084/Mum/2011, the penalty so levied has no legs to stand. We direct the AO to delete the penalty.

14. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court on 31st March, 2016.

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| Sd/- | Sd/- |
| **(AMIT SHUKLA)** | **(R.C. SHARMA)** |
| **JUDICIAL MEMBER** | **ACCOUNTANT MEMBER** |

Mumbai, Date : 31st March, 2016
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Copy to :
1) The Appellant
2) The Respondent
3) The CIT(A) concerned
4) The CIT concerned
5) The D.R, "A" Bench, Mumbai
6) Guard file

By Order

Dy./Asstt. Registrar
I.T.A.T, Mumbai