

Musthafa Ummer and anr. Vs. Appropriate Authority and ors.

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Court : Kerala

Decided On : Jan-05-2001

Reported in : [2001]248ITR436(Ker)

Judge : M. Ramachandran, J.

Acts : Income-tax Act, 1961 - Sections 269UC and 269UD

Appeal No. : O.P. No. 6872 of 1990-R

Appellant : Musthafa Ummer and anr.

Respondent : Appropriate Authority and ors.

Advocate for Def. : P.K.R. Menon and; George K. George, Advs.

Advocate for Pet/Ap. : M. Pathrose Mathai,; P.K. Suresh Kumar and; M.R. Sreelat

Judgement :

M. Ramachandran, J.

1. Proceedings of the appropriate authority exercising pre-emptive powers of purchase under Section 269UD of the Income-tax Act, 1961, are under challenge. The validity and propriety of exhibits P-7, P-9, P-9(a) and exhibit P-11 as also the further proceedings pursuant thereto are questioned in this original petition filed by

the power of attorney holder, Sri Afsal Muhammed Moosa Alayadath representing Musthafa Ummer and Rafeena Musthafa, who are shown as petitioners. The first respondent is the appropriate authority, Income-tax Department, Bangalore ; and the second and third respondents respectively are the Chief Commissioner of Income-tax, Cochin, and the Government of India.

2. The averments in the original petition which are relevant for the purpose of adjudication are given as below :

3. The petitioners had promoted a company Palm Court Hotels Private Limited. A certificate of incorporation, memorandum of association and the articles have been produced as exhibit P-2 in the original petition. The petitioners were the sole two directors of the company so registered. The idea was to set up a hotel complex on the plot of land jointly belonging to the petitioners, in their individual names, in the City of Cochin. They had approached the Kerala State Industrial Development Corporation Limited (KSIDC) for financial assistance. It is stated that a term loan of Rs. 250 lakhs had been sanctioned. The project cost and the means of finance of the project was agreed to be met by them on condition that the properties in the name of the promoter directors were to be got registered in the name of the company, so that the company could mortgage it in favour of the KSIDC, by way of security.

4. The transfer was necessitated in the aforesaid circumstances. The project cost, according to the petitioners, had been reckoned by considering the cost of the land acquired by the promoters and by adding to it the conveyance charges. The agreement as envisaged under Section 269UC had been drafted, and the statement had been furnished to the appropriate authority in Form No. 37-I. The petitioners heavily relied on the above circumstance which was certified by the KSIDC as exhibit P-5, the relevant text of which is extracted herein below :

'We hereby certify that the Kerala State Industrial Development Corporation Ltd., has sanctioned a term loan of Rs. 250 lakhs for Palm Court Hotels (Pvt.) Ltd., to set up a three star category hotel project at Ravipuram, Cochin. Cost of the project approved was Rs. 510 lakhs and the approval was given in our board meeting held in March, 1998.

We also certify that the cost of land purchased by the promoters considered in the project was Rs. 66.99 lakhs as per document rates. This amount is the cost to transferor and our corporation has insisted for further registering the land in the name of Palm Court Hotels (Pvt.) Ltd. at cost, for which a conveyancing charge of Rs. 9.04 lakhs is also provided. Accordingly, the total cost of land considered in the appraisal is Rs. 76.03 lakhs.'

5. Exhibit P4 was the memorandum of terms and conditions for sanction of the term loan and the special conditions, referred to earlier. As could be seen from exhibit P-4, one of the special conditions is that the land registered in the name of the promoter directors should be registered in the name of the company towards mortgaging to the KSIDC.

6. The petitioners were awaiting clearance from the Department, but the first respondent had issued a letter on February 12, 1999 (exhibit P-7), conveying their decision that the appropriate authority proposed to pass an order for pre-emptive purchase of the property under Section 269UD of the Income-tax Act for Rs. 66,99,100. Thereupon a written representation had been filed by the petitioners objecting to the proposal. In due course they had been given an opportunity for hearing, but it appears that the first respondent had proceeded with the proposal and passed an order for preemptive purchase in exercise of the powers under Section 269UD of the Act. Exhibit P-9 is the said order. The petitioners had made a further representation to the Chief Commissioner of Income-tax, but no orders had been passed thereon and exhibit P-11 is produced as the follow up order dated March 3, 1999, requiring the delivery of possession of the property. The original petition has been filed at this juncture.

7. The petitioners submit that the proceedings issued by the first respondent were illegal and unwarranted. The main contention is that the orders suffer from errors apparent on the face of the records and they are vitiated. It is submitted that the object sought to be achieved by the statutory provision invoked had been thoroughly overlooked and the nature and purport of the transaction had been completely omitted to be appreciated and in a deliberate manner. It was also submitted that the reply to the show-cause notice had been totally overlooked and

there was miscarriage of justice. There is also an allegation that the order was in gross violation of the principles of natural justice and the materials that had been stated as collected and relied on by the first respondent have not been divulged. It is also stated that the relevant aspects had been totally overlooked and the order has been issued on conjectures and surmises. In short, the petitioners submit that there was total miscarriage of justice and the decisions are, therefore, liable to be set aside.

8. Counter affidavits had been filed by the appropriate authority and they have resorted to a stand that what has been done in the case at hand was perfectly legal. They had come to a proper finding on the basis of facts disclosed and it was a bona fide exercise of power when they found that there was gross undervaluation of properties and the circumstances was really at large requiring exercise of powers under Section 269UD of the Act.

9. Exhibit P-7 is a show cause notice and the members of the appropriate authority had inspected the abovesaid premises and had considered the engineering report prepared by the executive engineer of the valuation cell. After considering the report and evaluating all the aspects, they had come to the conclusion that the apparent consideration shown in the statement was well below 15 per cent, of the market value of the property. The reasons for such conclusion were given as follows :

'The property is located in Srikanth Road off M. G. Road on the eastern side of M. G. Road. The distance from M. G. Road to the property is 70 metres. The locality is residential and commercial mixed. Multistoreyed apartments are existing nearby this property. The potential for commercial development is very high due to its location in the nucleus of Cochin City, the commercial capital of Kerala. The land rate works out to Rs. 2,16,100 per cent (without considering the cost of piles already driven).'

10. Reference had also been made to another transaction where the consideration found was far higher. It was therefore stated that the case was covered by the decision of the Supreme Court in C.B. Gautam v. Union of India : [1993]199ITR530(SC) . The proceedings also referred to an inference of a

presumption that undervaluation had been done with a view to evade tax.

11. It is found that the representation submitted by the petitioners in answer to the above was quite extensive and is produced as exhibit P-8. The main point highlighted was that the statement in Form No. 37-I was filed in view of very special circumstances and, therefore, the case could not have been compared with any normal transfer of assets between two persons. It was a case where both the transferors and transferees are the same persons and the transfer of the property was necessitated so as to meet the requirements of the financier, whereunder the property was to be in the name of the company and to be mortgaged to them as security. There was no transfer of any money involved and the consideration was shown as issue of 6,69,910 shares of Rs. 10 each of Palm Court Hotels (P.) Ltd. Exhibit P-8 further proceeded to say that though the property is situated in Cochin City, it was lying on a by-lane which connects Chittoor Road to M. G. Road and the property that had been referred to exhibit P-7 is not comparable by any stretch of imagination. Reference had also been made to transactions which had taken place, where properties were sold at lower prices than the value shown by the petitioners. The petitioners had also urged that a higher price commensurate with the market rate and far greater than the price paid by them for acquiring the abovesaid property in 1994 was shown. The Department had not made objections when an application had been filed in respect of the very same property in the year 1994.

12. Notwithstanding the above, as pointed out earlier, by exhibit P-9, discretion was exercised for pre-emptive purchase as had been proposed by exhibit P-7. It was observed that on comparison the fair market value of the subject property cannot be less than Rs. 4 lakhs per cent and, therefore, they are satisfied that the apparent consideration shown in the sale agreement is below the market value by almost 50 per cent. Undervaluation with a view to evade tax was highlighted as reason for the decision.

13. Mr. M. Pathrose Mathai, counsel appearing for the petitioners, pointed out that apart from the general objections, there is evidence to show that there is total non-application of mind. He has stated that the first respondent was under a mistaken

impression that the transferors were totally three, whereas there was no outsider and the transferees and transferors were only two persons, husband and wife. According to him, the appropriate authority had lost sight of the very fundamental objection taken, since in exhibit P9 it had been observed as follows :

'One of the arguments taken by counsel was that the transfer was effected at the instance of the KSIDC and that the KSIDC had insisted that the value should not be more than the book value in the transferor's hands. However, he could not produce any documentary evidence to establish or even suggest that the KSIDC had stipulated any such condition. Therefore, counsel's contention that the rate at which the transfer was effected was dictated by the KSIDC and there was no intention to avoid tax cannot be accepted.'

14. According to counsel, it was sufficient to show that no thought had been bestowed though all the relevant documents were produced to show that it was only at the instance of the KSIDC that this transfer had been done and solely to make it a security for the loan that was urgently required for the company. A higher consideration if shown would have been advantageous to them as a higher amount of loan could have been demanded, but in view of the stipulations of the financier, a realistic approach was required to be adopted, and that alone had been done.

15. Senior counsel for the Revenue had supported the impugned orders. He had submitted that the transferees are totally different from the transferors, they being a limited company. It was also not essential that there is cash transaction, as shares also are equivalent to cash. No principle of natural justice has been violated and the reports which constituted the basis of the finding had been made available to the petitioners and in any case even if not made available the orders are sufficiently clear to denote the nature of the finding of the engineer who had made the report. No other minutes had been prepared by the members of the appropriate authority at the time of inspection and they were highly placed competent officers who had discharged their duties most efficiently and no interference is called for.

16. Chapter XX-C of the Income-tax Act had been introduced in October, 1986. This was since it was found that the scheme brought in for acquisition of immovable properties by the Central Government in certain cases of transfer to counteract evasion of tax, did not achieve its objects. The present scheme empowers the Government to purchase immovable properties which are being offered for sale in the market at the price agreed to by the transferor and in selected cities. The only exemption is when the transfer is to close relatives and where the documents indicate that such conveyance was out of love and affection. There cannot be, therefore, any dispute for the proposition that it was a case of transfer and the petitioners were obliged to file a statement and it was the duty of the appropriate authority to examine the issue and pass orders.

17. Counsel for the petitioners had heavily relied on the decision of the Supreme Court, namely, *State of U. P. v. Renusagar Power Co.* [1991] 70 Comp Cas 127. The Hindustan Aluminium Company had been allowed to expand its aluminium production capacity on condition that they will install their own power plant. The company had decided to set up a captive power house through the instrumentality of Renusagar Power Co. Ltd., a 100 per cent, subsidiary fully controlled by Hindalco to supply power exclusively to them. By virtue of the provisions of the U. P. Electricity (Duty) (Amendment) Ordinance, it had been provided for non-levy or exemption from the payment of electricity duty on the energy consumed by a consumer in a scheduled industry. Electricity duty was payable where the energy is consumed by any outsider. The question had arisen whether the power consumed from the Renusagar Power Company attracted a duty. The contention was that consumption of energy by Hindalco is consumption by Hindalco from its own source of generation. Thus, the question was whether the Renusagar Power Company would be Hindalco's own source of power generation. The Supreme Court had held that the corporate veil should be lifted and Hindalco and Renusagar were to be treated as one concern for the purpose of treating it as 'own source of generation.' The contention urged by learned counsel on the strength of the decision was that the petitioners were none other than the company itself and since there were no outsiders the sale was only a transfer among themselves and the principle was well established that a person by a transfer to himself cannot derive the benefit. It was a case where a scrutiny as envisaged by the section was

permissible, but the power of pre-emptive purchase could not have been exercised and the appropriate authority had, therefore, blindly come to the impugned decision.

18. It is, however, true that profit may actually be realised or realisable and transfer among themselves did attract the impact of the section. A company is a juristic person and distinct from shareholders (see *Bacha F. Guzdar v. CIT* : [1955]27ITR1(SC)). The order of the appropriate authority as pointed out by counsel for the Revenue is required to be given due weight and could not lightly be disturbed. It has been submitted by Sri Menon that there is an admission in the original petition that the real value of the property might have been omitted to be incorporated in Form No. 37-I statement (see averments in ground 'N' of the original petition). It may be that profits include anything capable of being turned into money from its own nature, as succinctly stated by Lord Halsbury L. C. (*Tennant v. Smith* [1892] 3 TC 164). The essence of the matter, it is submitted, is that there need be profit realised or realisable under the concept of income. When a company sells its trading assets for fully paid shares in another company, the profit on the transaction is assessable although no cash passes (*Californian Copper Syndicate v. Harris* [1904] 5 TC 159 (C of Exchq)). Counsel also adverted to the decisions reported in *CIT v. Sir Homi Mehta's Executors* : [1955]28ITR928(Bom) and *CIT v. B.M. Kharwar* : [1969]72ITR603(SC) , but it appears that these principles do not come to support the stand of the Department, since the nature of the transaction in the case at hand is rather unique.

19. Both sides had relied on C.B. Gautam's case : [1993]199ITR530(SC) , referred to earlier. It was a case where the petitioner, the intending purchaser had challenged the decision of the appropriate authority. The validity of the section had been upheld by the Supreme Court and the court had examined in detail the purpose of the legislation, and the principles which are to be borne in mind while exercising powers under section 269UD. Examining the facts of the case, I am constrained to observe that the authority has practically omitted to take note of the primary contention of the petitioners that it was not a case of a sale as understood in the ordinary parlance. Neither exhibit P-7 nor exhibit P-9 shows that the above has been adverted to, and the consideration has been confined to the location of

the premises and the general prices available in the region. In the affidavit filed, the appropriate authority has however suggested that sufficient materials regarding the transaction had not been made available to them to highlight the special nature of the transaction. But, it does not tally with the records available. There has been no advertance to exhibit P-8, when it was specifically stated that the joint owners of the property were the sole directors of the limited company as well. If the above argument was adverted to or rejected after a discussion, there could have been justification in the stand taken in exhibit P-9. But, it is a case where the objections have not been noticed at all. It is not in every case that pre-emptive purchase is to be done. It has to be ordered when there is deliberate undervaluation of property, so as to give a reasonable presumption that a consideration higher than what is shown in the document had passed between the parties. This was not at all the situation in the case at hand. For this sole reason, I am of the opinion that exhibit P-9 is to be held as one issued without proper application of mind, and also without appreciating the basic idea underlying the statutory provision.

20. On a consideration of the relevant materials, I am of the view that the appropriate authority was not justified in passing the impugned orders, whereunder the proposal was finalised for pre-emptive purchase of the property in question. As found in the decision in C.B. Gautam's case : [1993]199ITR530(SC) , the Additional Solicitor General had submitted that in exercise of such power, the transferor was hardly affected and if at all, the interests of the transferee alone stood prejudiced. This was for the reason that the transferor was to get the price that had been quoted by him and he did not stand to any disadvantage as it could not have been stated that the actual price which had been agreed was something else. This is a pointer to show that only in cases where there are transfers and where properties are offered for sale in the market, i.e., to outsiders, the Government had visualised to intercept and proposed to reserve powers for pre-emptive purchase. The purpose behind the legislation was to see that there was no evasion of tax by undervaluation. If that be so, as pointed out by counsel for the petitioners, the substantial contention raised by them has practically gone unnoticed. It was not a case where there was a transfer which involved payment of cash. The transfer was in fact against the will of the petitioners and they were

directed to effect the transfer in favour of a company in which they were directors and only for the purpose highlighted in exhibit P-4. They had to incur a stamp duty of about Rs. 9 lakhs. A higher price shown would have enured to their advantage only. Only out of compulsion, these exercises were attempted and it is hardly a case where the powers vested in the Revenue under Section 269UD of the Act were to be employed. The petitioners had also pointed out the circumstances that the self same property had been purchased by them a couple of years back and in comparison with the price paid the figure shown in the statement was eminently reasonable. As pointed out by the petitioners, they had purchased the properties adjacent to the above and if they were dispossessed by the pre-emptive purchase, their project would have derailed and all the preliminary steps taken, including the formation of the company, might have been jeopardised. Above all, the transactions were not intended to defeat the interests of the Revenue, as is ordinarily understood. This principal contentions stands overlooked and it was by far the most crucial point. The orders have resulted in serious prejudice to the petitioners. Though a detailed counter affidavit had been filed by the members of the appropriate authority, it has not been able to substantiate the reasons for coming to the conclusion that there was undervaluation and thereby evasion of tax. A comparison of prices in the area will lead one nowhere, as the lie of the property was the most important single factor which decided its price. The petitioners' counsel is also justified in pointing out that the reports of the engineer had not been supplied to them and the minutes of the inspection also had been withheld. These materials are relevant in a normal case, but since I have found that basically the appropriate authority has failed to take note of the unique circumstances in which the transfer was necessitated and the orders are vitiated, I am not going into other aspects in detail.

21. In the aforesaid circumstances, I have to hold that exhibits P-7, P-9, P-9(a) and P-11 are liable to be set aside. The petitioners' application, filed as exhibit P-6, may be taken up for fresh consideration and appropriate orders passed thereon as envisaged under law.

22. The original petition is allowed. There will be no order as to costs.

