K.R. Srinath Vs. the Assistant Commissioner of Income Tax

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SooperKanoon Citation : sooperkanoon.com/816708

Court : Chennai

Decided On : Apr-20-2004

Reported in : (2004)190CTR(Mad)517; [2004]268ITR436(Mad)

Judge : A.S. Venkatachalamoorthy and ;P.K. Misra, JJ.

Acts : Income Tax Act, 1961 - Sections 2, 2(14), 2(47), 12B, 45 and 54; Income Tax Act, 1969 - Sections 4; Constitution of India

Appeal No. : T.C. (A) No. 59 of 2002

Appellant : K.R. Srinath

Respondent : The Assistant Commissioner of Income Tax

Advocate for Def. : K. Subramaniam, Sr. Standing Counsel

Advocate for Pet/Ap. : V.S. Jayakumar, Adv.

Disposition : Appeal dismissed

Judgement :

A.S. Venkatachalamoorthy, J.

1. The assessee on 3rd April, 1986 entered into an agreement to purchase an extent of 7394 sq.ft., in S.No.35/3 situate at Geddadahalli village, Bangalore, belonging to one Krishnamurthy, for a total consideration of Rs.2,00,000/-. On the

date of agreement, a sum of Rs.40,000/- was paid by him and it was further agreed that the balance of Rs.1,60,000/- would be paid at the time of execution and registration of sale deed. Both parties reserved the right to specific performance of the agreement. Nearly four years thereafter, that was on 21.3.1990, again another agreement was entered into in the nature of deed of cancellation, in and by which the assessee agreed for termination of the earlier agreement and allowed the owner of the land to sell the said property to any person and at any price of his choice. As a consideration for this, the assessee was paid a sum of Rs.6,00,000/-, apart from refunding the advance of Rs.40,000/- to the assessee.

2. The assessee filed returns of income for the assessment year 1990-1991 admitting a total income of Rs.2,70,150/- including Rs.2,59,000/- as capital gains. The assessee had returned the capital gains on the sum of Rs.6,00,000/- received from the said Krishnamurthy. In the assessment, the Assessing Officer computed the capital gains at Rs.2,90,000/- after allowing deduction for Rs.5,000/- as amount spent on 31.3.1989 towards enforcing the deal of purchase. The assessee then took up the matter in appeal with the plea that the amount received as compensation for breach of contract was not liable to be assessed as capital gains. There was also a contention that in any case there could be no assessment as capital gains as there was no cost of acquisition incurred by him. The Commissioner of Income Tax took the view that the assessee had acquired a legal right as per the earlier agreement dated 3.4.1986 and so the amount received for giving up that right is liable to capital gains tax. The aggrieved assessee thereafter took up the matter further by filing ITA No.870 of 1994. The Income Tax Appellate Tribunal confirmed the view taken by the Commissioner of Income Tax, who held that the sum of Rs.6,00,000/- received by the assessee is subject to capital gains tax. Questioning the correctness of the said order, the assessee has now filed this tax case appeal before this Court.

3. The learned counsel appearing for the assessee contended before this Court that there was no transfer of any property by the assessee to make him liable for assessment under capital gains and the sum of Rs.6,00,000/- received by the assessee was for agreeing to cancel the earlier agreement dated 3.4.1986 and

that the assessee had not transferred that right to anybody. The learned counsel further submitted that the assessee had not transferred the right to anybody, not even to the vendor and that the deed executed on 21.3.1990 is nothing but a deed of cancellation, cancelling the earlier agreement. The attention of this Court is also drawn by the learned counsel appearing for the assessee that as per the deed of cancellation both the party treated the payment only as compensation and that being so there could be no liability towards capital gains tax. The further plea is that cancelling the right in the property by deed of cancellation was not a case of transfer of that right. Yet another submission is made to the effect that there could be no assessment to the capital gains where there was no cost of acquisition incurred by the assessee for acquiring the right in the property.

4. The learned counsel appearing for the Revenue contended that under the agreement dated 3.4.1986, the assessee had acquired a right in the property. The word 'property' used in Section 2(14) of the Income Tax Act is a word of widest amplitude and that any right that could be called property would be included in the definition of 'capital asset'. Under the agreement, the assessee acquired a right to obtain a conveyance of an immovable property and that was a property as contemplated under Section 2(14). The learned counsel explained that by entering into a deed of cancellation, the assessee relinquished the right, which he acquired under the first agreement, accepting a sum of Rs.6,00,000/- from the owner of the land. The assessee had extinguished his right in an immovable property as per section 2(47). The case involved a transfer attracting liability to capital gains tax. On the question of cost of acquisition, the learned counsel contended that the assessee had incurred a cost of Rs.40,000/- which was paid to the vendor at the time of making up the agreement on 3.4.1986 and that the said sum paid as advance is the actual cost of acquisition. According to the learned counsel for the Revenue, the appeal is devoid of merits and liable to be dismissed.

5. The question that arises for consideration is as to whether the amount of Rs.6,00,000/- received by the assessee from the vendor cannot be treated as capital gains in the hands of the assessee.

6. Before we proceed to the relevant provisions in the Act and the Rules referred to, we deem it necessary to quote the relevant paragraphs in the two agreements. Clause No.2 and Clause No.6 in the agreement dated 3.4.1986 read as under,

'2. The consideration for sale shall be Rs.2,00,000/- (Rupees Two Lakhs only) which shall be paid as under:-

a) Rs.40,000/- (Rupees Fourty thousand only) has been paid as and by way of advance

b) Rs.1,60,000/- (Rupees One Lakh sixty thousand only) shall be paid at the time of execution and registration of sale deed.

6. Both the Vendor and the Purchaser shall have right to specific performance of this agreement.'

Paragraph 4 and clause No.2 in the agreement dated 21st March, 1990 are as follows,

'WHEREAS the Vendor has sought for cancellation of the said Agreement and in consideration thereof has agreed to refund the advance and further pay the compensation of Rs.6,00,000/- (Rupees six lakhs only) to the Purchaser and the Purchaser has agreed for the same.

2. In consideration of the Purchaser agreeing for termination of the said agreement and allowing the Vendor to sell the said Property to any person and at any price, the Vendor has paid the Purchaser the consideration of Rs.6,00,000/- (Rupees Six lakhs only) apart from refunding the advance of Rs.40,000/- (Rupees Forty thousand only) received by the Vendor, by Demand Draft of Indian Bank, Malleshwaram, Bangalore, the receipt of which the Purchaser herein hereby acknowledges as having been received.'

7. Section 45 of the Act is to the effect that any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 54 etc., be chargeable to income-tax under the head 'Capital gains', and shall be deemed to be the income of the previous year in which the

transfer took place.

Section 2(14) reads as follows,

'Capital asset' means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include .....'

The next relevant provision is Section 2(47), which is to the following effect, 'transfer', in relation to a capital asset, includes,-

(i) the sale, exchange or relinquishment of the asset; or

(ii) the extinguishment of any rights therein; or(iii) .....'

8. (i) In Ahmed G.H. Ariff and others v. Commissioner of Wealth-Tax, Calcutta, : [1970]76ITR471(SC) , the Supreme Court while considering the question whether in the facts of that case the right of the assessee to receive a specified share of the net income from the Wakf estate is an asset, the capitalised value of which is assessable to wealth tax, observed as follows,

' 'property' is a term of the widest import and, subject to any limitation which the context may require, it signifies every possible interest which a person can clearly hold or enjoy. ...'

The Court also pointed out that in Commissioner, Hindu Religious Endowments v. Shri Lakshmindra Thirtha Swamiar of Sri Shirur Mutt : [1954]1SCR1005 it was held that there was no reason why that word should not be given a liberal and wide connotation and should not be extended to those well-recognised types of interests which had the insignia or characteristic of proprietary right.

(ii) The Constitution Bench in R.C. Cooper v. Union of India, : [1970]3SCR530 , ruled as under,

'... In its normal connotation 'property' means the 'highest right a man can have to anything, being that right which one has to lands or tenements, goods or chattels which does not depend on another's courtesy: it includes ownership, estates and interests in corporeal things, and also rights such as trade-marks, copy-rights,

patents and even rights in personam capable of transfer or transmission, such as debts; and signifies a beneficial right to or a thing considered as having a money value, especially with reference to transfer or succession, and to their capacity of being injured'. The expression 'undertaking' in Section 4 of Act 22 of 1969 clearly means a going concern with all its rights, liabilities and assets - as distinct from the various rights and assets which compose it. In Halsbury's Laws of England, 3rd Edn., Vol.6, Article 75 at p.43, it is stated that 'Although various ingredients go to make up an undertaking the term describes not the ingredients but the completed work from which the earnings arise.'

(iii) The High Court of Bombay had occasion to consider a case reported in : [1980]122ITR594(Bom) (C.I.T. vs. Tata Services Ltd.), where the assessee had entered into an agreement with one Seth Anandji Haridas to purchase a residential plot at a particular price and also paid an advance and the owner of the land was expected to clear some formalities with the Municipal Authorities. The vendor could not obtain necessary permission from the said authorities. The assessee, vendor and another person M/s. A&B; entered into a tripartite agreement pursuant to which the assessee transferred and assigned in favour of M/s. A&B;, its right, title and interest under the agreement and received a particular sum as consideration for the transfer and assignment of assessee's right, title and interest under the agreement. The question arose as to whether tax can be levied on the sum received by the assessee. A Division Bench of Bombay High Court took the view that the transferred rights in favour of the third party by the assessee clearly fell within the definition of capital gains in clause 14 of Section 2 of the Act and the difference amount received by the assessee (i.e, the amount received from the third party minus earnest money paid by him) would be capital gains in the hands of the assessee and subject to deduction on account of legal and other expenses. We hereunder extract the relevant portion from the said judgment,

'What is a capital asset is defined in s. 2(14) of the I.T. Act, 1961. Under that provision, a capital asset means property of any kind held by an assessee, whether or not connected with his business or profession. The other sub-clauses which deal with what property is not included in the definition of capital asset are not relevant. Under s. 2(47), a transfer in relation to a capital asset is defined as

including the sale, exchange or relinquishment or the asset or the extinguishment of any right therein or the compulsory acquisition thereof under any law. The word 'property', used in s. 2(14) of the I.T. Act, is a word of the widest amplitude and the definition has re-emphasised this by use of the words 'of any kind'. Thus, any right which can be called property will be included in the definition of 'capital asset'. A contract for sale of land is capable of specific performance. It is also assignable. (See Hochat Kizhakke Madathil Venkateswara Aiyar v. Kallor Illath Raman Nambudhri, AIR 1917 Mad 358). Therefore, in our view, a right to obtain conveyance of immovable property, was clearly 'property' as contemplated by s. 2(14) of the I.T. Act, 1961.'

(iv) The next ruling that can be usefully referred to be the one reported in 186 ITR 693 (C.I.T. v. Vijay Flexible Containers). In that case, the assessee is a firm entered into an agreement with one person to purchase the property at a particular rate. The assessee also paid a sum of Rs.17,500/- as earnest money. As the vendor failed to perform his part of the contract, the assessee was constrained to file a suit for specific performance of the agreement for sale, or in the alternative, for damages for its breach. Consent terms were arrived at in the suit and a decree was passed in favour of the assessee for the sum of Rs.1,17,500/- and interest. The question arose whether that amount received by the assessee was a capital asset. A Division Bench of Bombay High Court held that under the agreement to purchase the property, the assessee had acquired the right to have the immovable property conveyed to him and under the law, he was entitled to exercise that right not only against his vendors but also against a transferee with notice or a gratuitous transferee. The assessee could have also assigned that right. Hence, what he acquired under the said agreement for sale was therefore property within the meaning of the Income Tax Act, 1961 and consequently a capital asset. The Court further held that his giving up of the right to claim specific performance by conveyance to him of immovable property was a relinquishment of the capital asset and therefore there was a transfer of a capital asset within the meaning of the Income-tax Act. The Court in the said Judgment has clearly mentioned that it does not find any reason to differ from the finding arrived at in : [1980]122ITR594(Bom) (C.I.T. v. Tata Services Ltd) and : [1980]123ITR441(Bom) (C.I.T. v. Sterling Investment Corporation Ltd.).

We find that the facts in the case on hand as well as that case are almost identical. We may straight away say that we are not inclined to take a different view than the one taken in the above said two rulings. We also find, in the said ruling, the High Court considered the rulings reported in : [1984]149ITR215(Delhi) (C.I.T. v. J. Dalmia); : [1987]164ITR664(Cal) (C.I.T. v. Ashoka Marketing Ltd.); and : [1987]168ITR164(AP) (C.I.T. v. Barium Chemicals Ltd.) now cited before us by the learned counsel for the assessee and various other rulings. The High Court has pointed out after referring to the facts and circumstances of those cases that those rulings would not apply to the facts and circumstances of the case on hand. We are in entire agreement with the Judgment of the Bombay High Court in : [1990]186ITR693(Bom) .

9. The learned counsel for the assessee placed reliance on certain rulings of the Supreme Court, which we now proceed to consider chronologically.

(a) The learned counsel submitted that in the ruling reported in : [1981]128ITR294(SC) (C.I.T. v. B.C. Srinivasa Setty), the Supreme Court held that the transfer of goodwill generated in a newly commenced business cannot be termed as an asset within the meaning of Section 45 of the Income-tax, 1961 and the transfer of goodwill initially generated in a business does not give rise to a capital gain for the purposes of income-tax. Likewise, mere giving up of the right to claim specific performance by conveyance to him of immovable property does not give to a capital gain for the purpose of the income-tax. The learned counsel also submitted that this ruling was not considered by the Bombay High Court in the ruling reported in : [1990]186ITR693(Bom) (cited supra).

We do not see any substance in the submission of the counsel for the assessee. The Supreme Court in that ruling clearly explained the peculiar characteristics of 'goodwill' and also pointed out that when goodwill generated in a new business is sold and the consideration brought to tax, what is charged is the capital value of the asset and not any profit or gain and that the date of acquisition of the asset is a material factor in applying the computation provisions pertaining to capital gain; but in the case of goodwill generated in a new business it is not possible to determine the date when it comes into existence.

(b) The next ruling referred to by the learned counsel for the assessee is the one reported in : [1989]177ITR198(SC) (C.I.T., Bombay v. Rasiklal Maneklal (HUF)). In that case the respondent held shares in one Company of the face value of Rs.100/- each and pursuant to the scheme of amalgamation, the sharers in that Company were to be allotted in another Company one share of Rs.125/- each for two shares in the first Company and the first Company was to be dissolved. The respondent was allotted 45 shares in the second Company. The Commissioner of Income Tax took the view that capital gains arose from the acquisition of 45 shares in the second Company and directed the Officer to revise the assessment. However, on appeal, the Appellate Tribunal took the view that the transaction was neither exchange nor relinquishment and therefore Section 12B was not attracted. On reference, the High Court confirmed the view of the Tribunal. On appeal, the Supreme Court affirmed the decision of the High Court holding that there was neither exchange nor relinquishment and no capital gains arose from the transaction. In that case, the Supreme Court pointed out that relinquishment takes place when the owner withdraws himself from the property and abandons his rights thereto and it presumes that the property continues to exist after the relinquishment. But however, in that case the court pointed out that upon amalgamation the Company in which the assessee holds shares stands dissolved, there is no relinquishment by the assessee.

We are of the considered view that this judgment may also will not advance the case of the assessee in any manner.

(c) : [1991]191ITR647(SC) (Vania Silk Mills P. Ltd. v. C.I.T.) was a case where the appellant Company carried on business of manufacture and sale of art-silk cloth. During 1957, it purchased machinery worth few lakhs and gave it on hire to another mill at an annual rent basis. The other mill, as bailee of the machinery, insured the machinery along with its own machineries against fire. Some time thereafter, a fire broke out in the premises of the other mill and caused extensive damages to the machinery belonging to the appellant. The Insurance Company settled the claim with the other mill, which received certain amount and out of which paid a few lakhs to the appellant on account of destruction of the machinery. The Tribunal took the view that the insurance amount was not received by the

appellant as transfer of capital asset and only on account of damage to its machinery and Section 45 was not attracted. The High Court reversed this finding. On appeal, the Supreme Court held that capital gains tax was attracted under Section 45 by transfer and not merely by extinquishment of rights howsoever brought about. The Court held that extinquishment of right not brought about by transfer was outside the purview of Section 45.

The learned counsel appearing for the assessee in this case would contend that in this case also there was a extinquishment of right because under the second document it only cancelled the earlier document and that this ruling would advance the case of the assessee. We are not inclined to accept this submission. The assessee had a right to claim for specific performance of the agreement and he readily gave up that for a consideration.

(d) In : [2000]243ITR158(SC) (Travancore Rubber and Tea Co. Ltd. v. C.I.T.), the assessee was a Plantation Company, engaged in the business of growing rubber and tea. In 1975, it entered into three agreements with three purchasers for sale of old rubber trees. Each of the purchasers paid a certain amount by way of earnest money and another purchaser by way of advance in respect of the respective agreements. Ultimately those three persons committed default and the Company had to sell it to third party, but at a loss. The Tribunal after considering various terms of the agreements held that the receipt by way of forfeiture was not assessable as revenue receipt but the earnest money was so assessable as income under other sources. On reference, the High Court held that the amounts in question were income receipts in the context of the situation. On appeal, the Supreme Court reversed the decision of the High Court. The Court in the facts and circumstances of the case and upon perusing the terms of the agreement between the parties came to the conclusion that the amount forfeiture by the Company was only compensation for breach of contract and the same may be treated as capital receipts. Also it is relevant to point out what was sold by the Company was rubber trees, which were not yielding at the relevant time and hence the subject matter of sale was only standing timber.

This Court is of the view that the said ruling of the Supreme Court would not apply to the facts of this case.

10. Thus, this Court finds that all the four rulings referred to by the learned counsel for the petitioner would not advance the case of the assessee.

11. As seen already, the assessee had a right to insist for specific performance, gave up the right readily and received a sum referred supra. There can be no doubt that by termination of earlier agreement and by allowing the vendor to sell the said property to any person at any price, the assessee had given up or relinquished his right of specific performance and as consideration of relinquishing that right, the assessee was paid a sum of Rs.6,00,000/-. The right, title and interest acquired under the agreement of sale clearly fall within the definition of capital asset (Section 2(14)). Instead of assigning the right to third party/parties, the assessee relinquished those rights. We have already seen that the definition of transfer in Section 2(47) is wide enough to include relinquishment of an asset.

12. With regard to the contention that there was no cost of acquisition incurred by the assessee for obtaining the rights under the agreement dated 3.4.1986 and consequently there could be no capital gains assessable, it is to be noted that at the time of agreement of the sale the assessee paid Rs.40,000/-. That payment was made pursuant to the agreement. Only by paying the said amount the assessee acquired the right to get the sale deed executed in his favour. At this juncture, we may refer to the observation in the decision of Bombay High Court in C.I.T. v. Tata Services Ltd : [1980]122ITR594(Bom) , where it is observed as under,

'The assessee had paid at the time of the execution of the agreement of sale Rs.90,000/-. He had then acquired a right to obtain a sale deed. When he gave up that right or assigned it in favour of M/s A&B;, he received Rs.5,90,000/- and Rs.90,000/- was treated as refund of consideration. Therefore, actual cost to the assessee of the right to obtain the sale deed on the date of the agreement of sale was Rs.90,000/-.'

Even in the other case referred supra, : [1990]186ITR693(Bom) (cited supra), the Bombay High Court held that the capital asset had been acquired at a cost of Rs.17,500/- paid as and by way of earnest money In that case also the Court observed as follows,

'We may at this stage also deal with the further argument that there was no consideration for the acquisition of the capital asset. In our view, the Court was right in the view it took that the payment of earnest money under the agreement for sale was the cost of acquisition of the capital asset.'

13. Now that we have come to the conclusion that the assessee incurred Rs.40,000/- for acquiring the right to acquire the sale deed, the contention of the learned counsel for the assessee that there is no cost of acquisition and so there could be no assessment of capital gain on the transfer of the capital asset falls to ground.

14. On the basis of the above discussion, this Court comes to the conclusion that there are no merits in the appeal and the same is liable to be dismissed.

15. The appeal is dismissed. No costs.