

## **Commissioner Of Income-Tax, Madras vs P.K.N. Co. Ltd. on 10 December, 1965**

**Equivalent citations: AIR1966SC1256, [1966]60ITR65(SC), AIR 1966 SUPREME COURT 1256, 1966 (1) MADLJ(CRI) 149, 1966 (1) ITJ 558, 1966 60 ITR 65, 1966 (1) SCJ 657**

**Bench: J.C. Shah, K. Subba Rao, S.M. Sikri**

### **JUDGMENT**

Shah, J.

1. A partnership styled P.K.N. was carrying on money-lending business in several towns in India and also in the Federated States of Malaya. In the course of its business the P.K.N. firm acquired rubber estates and other immovables in the Districts of Muar and Segamat in the Federated States of Malaya. On December 4, 1937, a private limited company was registered in the name of P.K.N. Company Ltd. - hereinafter called "the company" - under the Pudukottai Company Regulation V of 1929 with its head office at Viswanathapuram, in the territories of His Highness the Maharaja of Pudukottai. The share capital of the company was of the face value of 6,60,000 Malayan dollars. Between March 23, 1939, and July 8, 1939, an area of more than 3,000 acres of rubber plantations, several houses and open plots of land, which were the assets of the P.K.N. firm, were transferred to the company for an aggregate consideration of 16,50,000 Malayan dollars. In consideration of the transfer of these properties, the company allotted shares of the face value of 6,60,000 Malayan dollars to the partners of the firm of P. K. N. and the balance remained outstanding as a debt due by the Company to the firm of P.K.N. On March 14, 1941 the Company purchased a rubber estate called the Lee Estate for 2,62,655 Malayan dollars. On July 7, 1941 the Company purchased for 5,000 Malayan dollars a house in co-ownership with another firm. In the year 1941 and 1942 some of the properties acquired from the firm of P. K. N. were sold by the Company. Between 1942 and 1945 the territory of Malaya was under occupation by the Japanese forces and it appears that during that period some houses belonging to the company were destroyed by fire. After 1945 some more lands admeasuring approximately 700 acres in the aggregate were sold by the Company.

2. On august 1, 1949, the state of Pudukottai integrated with the Province of Madras, and after the extension of the Indian Income-tax Act to that territory, the company was assessed by the Income-tax Officer, Pudukottai, as a dealer in real estate and profits amounting to 34,272 Malayan dollars and 40,613 Malayan dollars were brought to tax in the assessment years 1949-50 and 1950-51. But the Income-tax Appellate Tribunal set aside the orders. The Tribunal observed that the activities of the company outside India were limited to the holding of properties, and deriving income therefrom, and that the properties did not come to the company in the course of its money-

lending business, nor could it be said that they were acquired for the purpose of resale at a profit, and that the company " was formed in order to take over these properties and it would be far from correct to say that the properties taken over were intended to be turned into stock-in-trade", and therefore profits realised by sale of the properties were of capital nature.

3. Before the order of the Tribunal was pronounced, the Income-tax Officer assessed the company for the assessment year 1951-52 on a total profit of 1,41,326 Malayan dollars earned from the sale of immovable properties. The Appellate Assistant Commissioner confirmed the order in appeal. On further appeal, the Income-tax Appellate Tribunal confirmed the order of the Appellate Assistant Commissioner observing that all the material facts were not brought to the notice of the Tribunal at the hearing of the appeals in respect of the earlier years. Thereafter, pursuant to a direction of the High Court of Madras under section 66(2) of the Income-tax Act, 1922, the Tribunal referred the following question for the opinion of the High Court :

"Whether, on the facts and circumstances of the case, the surplus of \$1,41,326 realised by the assessee-company by the sale of some of its estates and properties held by it in Malaya was income chargeable to tax under the Indian Income-tax Act ?"

4. The High Court answered the question in favour of the company and held that the amount sought to be brought to tax was not income chargeable under the Indian Income-tax Act. With special leave, the commissioner of Income-tax has appealed to this court.

5. In a recent judgment, Janki Ram Bahadur Ram v. Commissioner of Income- tax, it was observed by this court at page 24 :

"it is for the revenue to establish that the profit earned in a transactions is within the taxing provision and is on that account liable to be taxed as income. The nature of the transaction must be determined on a consideration of all the facts and circumstances which are brought on the record of the income-tax authorities. It has consistently been held by this court that the question whether profit in a transaction has arisen out of an adventure in the nature of trade is a mixed question of law and fact."

6. It was further observed :

"... the question whether a transaction is an adventure in the nature of trade must depend upon the collective effect of all the relevant materials brought on the record. But general criteria indicating that certain facts have dominant significance in the context of other facts have been adopted in the decided cases. If, for instance, a transaction is related to the business which is normally carried on by the assessee, though not directly part of it, an intention to launch upon an adventure in the nature of trade may readily be inferred. A similar inference would arise where a commodity is purchased and sub- divided, altered, treated or repaired and sold, or is converted into a different commodity and then sold. Magnitude of the transaction of purchase, the nature of the commodity, subsequent dealing and the manner of disposal may be

such that the transaction may be stamped with the character of a trading venture;... But a transaction of purchase of land cannot be assumed without more to be a venture in the nature of trade... a profit motive in entering into a transaction is not a decisive, for, an accretion to capital does not become taxable income, merely because an asset was acquired in the expectation that it may be sold at profit."

7. The company was apparently floated with the object of taking over the assets of the P.K.N. firm, for soon after it was formed, the company took over a substantial part of the assets of the P.K.N. firm and allotted the whole of its issued capital in part consideration thereof and for the balance the company pledged its credit. The memorandum of association of the company contains the following important clauses :

"(ii) To carry on business as merchants, commission agents, financiers, concessionaires, mill owners, land and house estate agents and to undertake and carry on an execute all kinds of financial, commercial business (except the issuing of policies of assurance on human life) which may seem to be capable of being conveniently carried on in connection with any of these objects or calculated directly or indirectly to enhance the value of, or facilitate the realisation of, or render profitable, any of the company's property or rights.

(XV) To purchase or otherwise acquire and to sell, exchange, surrender, lease, mortgage, charge, convert, turn to account, dispose of and deal with property and rights of all kinds, and in particular, mortgages, debentures, produce concessions, options, contracts, patents, annuities, licences, stocks, shares, bonds, policies, book debts, business concerns, undertakings, claims, privileges and choses in action of all kinds.

(XVI) To sell, mortgage, let, exchange, manage, improve, cultivate, develop, dispose of, turn to account or otherwise deal with all or any part of the properties, rights and privileges of the company upon any terms, and for any consideration."

8. Barring acquisition of a half share in the house purchased on July 7, 1941, for 5,000 Malayan dollars, the purchase of assets by the company was in two lots. The first lot was purchased between March 23, 1939, and July 8, 1939, from the P.K.N. firm for 1,650,000 Malayan dollars, and the other which was the Lee Estate, was purchased on March 14, 1941. From the statements of account of the company, it appears that large amounts of money were spent on cultivation and development of the rubber and coconut estates, and substantial income was derived therefrom. The total area of 3,000 acres originally transferred by the P.K.N. firm on the formation of the company was apparently not a compact block and the company was unable to administer the far-flung estates in different places effectively and economically, and on that account certain small plots of land were sold in 1940 and 1941. Between the years 1942 to 1945, the territory of Malaya was under Japanese occupation and during that period also some plots of land were sold. Thereafter in 1948, 1949 and 1950 lands were sold from time to time and profits were made. As a result of these disposals, the total holding of the Company was reduced to about 2,000 acres of rubber estates, besides some houses acquired from

the P. K. N. firm and the Lee Estate.

9. The following table which has been incorporated in Paragraph 8 of the case submitted by the Tribunal gives in the form of a tabulated statement the acquisitions and disposal from time to time :

Year Purchase Sale Profit Loss of account of properties of properties				
( 1 )	( 2 )	( 3 )	( 4 )	
Year ended 31-3-39 1,577,560 ... ..				
...				
31-3-40	67,213	7,917	3,366	
31-3-41	262,655	10,188	3,259	
31-4-42	5,000	51,821	15,041	...
31-3-43	4,400	4,000		...
30,600				
31-3-44	...	3,331	1,881	...
31-3-45	500	267,610	232,751	
...				
31-3-48	...	17,500	7,500	
...				
31-12-48	...	188,145	37,220	
...				
31-12-49	...	120,734	43,333	
31-12-50	1,000	326,462	140,899	
T o t a l 1 , 9 1 8 , 3 2 8 9 9 8 , 0 7 8 4 8 5 , 2 5 0 3 2 , 4 5 4				

These represent transfers only.

On an analysis of this table, it is clear that there were no fresh acquisitions after July 7, 1941, till 1950. The two items mentioned in the year of account ending March 31, 1943, and March 31, 1945, are only transfer entries. 30,600 Malayan dollars entered in the last column in the year ending March 31, 1943, it is common ground, represents loss by fire and does not represent loss as a result of a sale transaction. Admittedly, there were sales spread over a number of years resulting in profit to the company. These sales were effected when opportunity arose or necessity dictated. It is not, however, disputed by the department that the primary activity of the company was that of planters. It is disclosed by the books of account maintained at the head office in India that during the year

ending March 31, 1948, the company spent on the estates about Rs. 3,50,000 and made realisations from the stocks of rubber exceeding Rs. 5,25,000. On the next year the expenditure was Rs. 3,31,000 and the receipts from rubber were Rs. 6,70,000. In the year ending December 31, 1950 the disbursements of the estates including salaries were Rs. 5,25,000 while the receipts by way of sales of rubber and stocks came to Rs. 16,50,000. These lend support to the view that the primary object of the Company was to function as planters and dealers in rubber, and that year after year the Company was extending its planting operations. It is true that some items of property purchased in the year 1939 were sold from time to time, but these were not transactions of purchase and sale of immovable properties indicating an intention on the part of the Company to treat its investment in immovable properties as an adventure in the nature of trade.

10. The reasons which appealed to the Tribunal in disagreeing with its earlier decisions that the company was carrying on business in real state may be summarised. The company in the year of assessment 1951- 52 realised a profit of 93,093.79 Malayan dollars from sale of rubber estates, 34,425 Malayan dollars from sale of house properties, 13,050 Malayan dollars from sale of jointly owned properties and 150 Malayan dollars from sale of "cocoanut tops", resulting in a net profit of 141,326.42 Malayan dollars : that the subscribed capital of the company was 660,000 Malayan dollars, whereas the acquisition of properties in the first three years was more than 1,800,000 Malayan dollars; that for acquiring its assets the company had of necessity to raise loans and to pay interest on those loans, and it was clear that the company was not formed solely for the purpose of acquiring assets of P.K.N. firm; that the company made large borrowings for the purpose of acquiring those properties and developing them and there were continuous sale transactions practically in each year ever since 1939-40; that the contention that the Company had to sell properties on account of political upheavals in the territories of Malaya could not be accepted; because no attempt was made to wind up the business and to leave the country; that after acquiring the properties, the Company incurred expenditure for developing them which indicated that the properties were purchased with a view to develop them and after developing them to sell them development and sales going on simultaneously; and that the Company purchased a property jointly with others for 5,000 Malayan dollars, and expended a large sum of money thereon and later sold it for a "handsome profit." It may be mentioned that this last statement was the result of misconception of evidence, and it was corrected by the Tribunal in the statement of the case.

11. But these facts found by the Tribunal do not, in our judgment, justify the inference that the acquisition of the estates was for the purpose of carrying on business in real estate. Existence of power in the memorandum of association to sell or turn into account, dispose of, or deal with the properties and rights of all kinds, has no decisive bearing on the question whether the profits arising therefrom are capital accretion or revenue income. In delivering the judgment of this court in *Karanpura Development Co. Ltd. v. Commissioner of Income-tax* 1 Hidayatullah J. observed at Page 377 :

"Ownership of property and leasing it out may be done as a part of business, or it may be done as land owner. Whether it is the one or the other must necessarily depend upon the object with which the act is done. It is not that no company can own property and enjoy it as property, whether by itself or by giving the use of it to

another on rent... In deciding whether a company dealt with its properties as owner, one must see not to the form which it gave to the transaction but to the substance of the matter."

12. In *Kishan Prasad and Co. Ltd. v. Commissioner of Income-tax* 2 it was observed that the circumstance whether a transaction is or is not within the company's power has no bearing on the nature of the transaction, or on the question whether the profits arising therefrom are capital accretion or revenue income.

13. *Raja J. Rameshwar Rao v. Commissioner of Income-tax* 3 was a case on the other side of the line. In that case a person acquired land with a view to selling it later after developing it and making the plots more attractive. This court held, having regard to the circumstances, that the venture was in the nature of trade, and the assessee was dealing with land as his stock-in-trade and carrying on business and making profits.

14. In *St. Aubyn Estates Ltd. v. Strick* 4 the appellant-company incorporated with powers to develop and dispose of lands and other property, acquired by purchase from the life tenant of a settled estate all the funds and properties subject to the settlement, including therein some twelve hundred acres of land adjoining a populous town. The company proceeded to develop a part of the land as building sites and to sell off portions of the estate as opportunities arose. Certain areas were laid out as desirable sites involving expenditure on development by the company, and the developed sites were sold in plots to applicants. The General Commissioners decided that the profits from sales of lands were profits of a trade or business and assessable to income-tax, and the High Court declined to interfere with that conclusion. It was observed by Finally J. :

"When one looks at the memorandum and articles, when one looks at the inception of the company, when one looks at what the company in fact did, it did in fact purchase, it did in fact develop, it did in fact sell and it did in fact make profits by selling. When one looks at all those circumstances, I think it is impossible to say that they do not constitute evidence upon which a Tribunal of fact might arrive at a conclusion that here there was a trade being carried on."

15. These cases merely illustrate that the nature of transaction must be determined on a consideration of all the circumstances, and the fact that a transaction is within the powers of a trading company is relevant but has standing alone not much significance.

16. The assessee-company did acquire two large blocks of properties between the years 1939 and 1941, but thereafter no substantial acquisitions were made. Limitation upon the admission of members to the company and other attendant features suggest an intention of conserving the properties of the members of the P.K.N. firm. Some of the houses purchased from the P.K.N. firm were destroyed by fire and the vacant sites and outlying properties were sold on account of difficulty of management of outlying portions of the estate. Occasional sales of small and unimportant portions out of the estate acquired from the P.K.N. firm was motivated by necessity and not to realize profits. The Lee Estate was never disposed of and it was treated as a nucleus for carrying on

profitable business of producing rubber and selling it on advantageous terms.

17. As already observed, determination of the question whether in purchasing and selling land the taxpayer enters upon a business activity has to be determined in the light of the facts and circumstances. The purpose or the object for which it is incorporated where the taxpayer is a company may have some bearing, but is not decisive, nor is the circumstance that a single plot of land was acquired and was thereafter sold as a whole or in plot decisive. Profit motive in entering into a transaction is also not decisive. Here, as already pointed out, the primary object of the company was to take over the assets of the P.K.N. firm to carry on the business of planters and to earn profit by sale of rubber. The incidental sale of uneconomic or inconvenient plots of land or houses could not convert what was essentially an investment into a business transaction in real estate.

18. The appeal is therefore dismissed with costs.

19. Appeal dismissed.