P. M. Mohammad Meerakhan vs Commissioner Of Income-Tax, Ernakulam on 12 February, 1969

Equivalent citations: 1969 AIR 1053, 1969 SCR (3) 659, AIR 1969 SUPREME COURT 1053

Author: V. Ramaswami

Bench: V. Ramaswami, J.C. Shah, A.N. Grover

PETITIONER:
P. M. MOHAMMAD MEERAKHAN

Vs.

RESPONDENT:
COMMISSIONER OF INCOME-TAX, ERNAKULAM

DATE OF JUDGMENT:
12/02/1969

BENCH:
RAMASWAMI, V.
BENCH:
RAMASWAMI, V.
SHAH, J.C.
GROVER, A.N.

CITATION:
1969 AIR 1053 1969 SCR (3) 659
1969 SCC (2) 25
CITATOR INFO :
R 1974 SC1364 (6)
RF 1986 SC1695 (34)
RF 1991 SC1338 (16)

ACT:
Income-tax Act (11 of 1922)-Single Transaction to purchase estate--No means to buy-Purchasers found-Plots sold and one retained--whether transaction constituted trade-Value of plot retained added for estimate profit, whether correct.

HEADNOTE:
The assessee entered into an agreement to purchase a land for Rs. 6 lakhs. He paid Rs. 11,000/- as advance and it was agreed that the sale deed was to be executed by a specified

date either in favour of the assessee or his nominees. The assessee did not have resources to buy land even worth a lakh nor could cultivate the land himself. He divided the land into 23 plots and found purchasers for 22 of these plots. These 22 plots were conveyed to the respective purchasers and the 23rd plot was conveyed to the assessee. The Income-tax authorities brought to tax the sum representing the assessee's profit (after including the estimated value of the plot retained by him). The assessee contended that (1) the transaction did not constitute a venture in the nature of trade; and (ii) even if it did, the profits from the adventure were not be properly ascertained as the adventure would terminate after the plots retained by the assessee was also sold and therefore the profits in the adventure could be determined only at the time of the completion of the We of the plot. Repelling these contentions, this Court,

HELD : (i) The question whether a transaction is an adventure in the nature of trade must be decided on a consideration of all the relevant factors and circumstances which are proved in the particular case. The answer to the question does not depend upon the application of any abs-tract rule or principle or formula but must depend upon the total impression and effect of all the relevant 'facts and circumstances established in the particular case. [662 A]

Having regard to the total effect of all the circumstances in the present case the transactions of the assessee constituted an adventure in the nature of trade and were in the course of the profit making scheme and were taxable.

California Copper Syndicate v. Harris, [1904] 5 S.T.C. 159, 165-6, Martin v. Lowry, II Tax Cases. 297, Rutledge v. Commissioners" of Inland Revenue, 14 Tax Cases 490, Commissioner of Inland Revenue v. Fraser, 24 Tax Cases 498, Leeming v. Jones, 15 Tax Cm" 333, Saroj Kumar Mazumdar v. Commissioner of Income-tax, 37 I.T.R. 242, Venkataswami Naidu & Co. v. Commissioner of Income-tax, 35 I.T.R. 594 and Raja J. Rameshwar Rao v. Commissioner of Income-tax, Hyderabad, 42 I.T.R. 179, referred to.

(ii) The profit of the assessee was correctly estimated by treating the land retained by him as stock-in-trade and valuing it according to the normal accountancy practice. Under the Income-tax Act for the purpose of assessment each year is a self-contained unit and in the case of a trading adventure the profits have to be computed in the manner provided by the statute. It is true that the income-tax Act makes no express provision with regard to the value of stock. It charges for payment of tax the

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income, profits and gains which have to be computed in the manner provided by the Income-tax Act. In the case of a trading adventure the profits have to be calculated and adjusted in the light of the provisions of the Income-tax Act permitting allowance prescribed thereby. For that

purpose it was the duty of the Income-tax Officer to find out what, profits the business has made according to the true accountancy practice. As a normal rule, the profit should be ascertained by valuing the stock-in-trade at the beginning and at the end of the accounting year. [666 E-H; 668 D]
Whimster & Co. v. Commissioner of Inland Revenue 12 Tax Cases 813, Commissioners of Inland Revenue V. Cock, Russell
JUDGMENT:

Madras v. A. Krishnaswami Mudaliar & Ors., 53 L.T.R. 122, referred to.

& CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1230 of 1967.

Appeal by special leave from the judgment and order, dated October 10, 1966 of the Kerala High Court in Income-tax Referred Case No. 18 of 1965.

S. T. Desai, Bhuvnesh Kumari, j. B. DadachanJi and O. C. Mathur, for the appellant.

Sukumar Mitra, R. N. Sachthey and B. D. Sharma, for the respondent.

The Judgment of the Court was delivered by Ramaswami, J. In this case the appellant (hereinafter called the assessee) was assessed for the assessment year 1956-57 on a total income of Rs. 8,400. The Income Tax Officer later on came to know that the assessee's income from the sale of estates had escaped assessment. The Income Tax Officer took action under section 34(1) (a) of the Income Tax Act, 1922 (hereinafter called the Act) for the assessment year 1956-57 on 13th August, 1959. Under an agreement dated 18th May, 1955 a company called Mundakayam Valley Rubber Co. Ltd. sold and delivered an estate called Kuttikal Estate to one Mr. A. V. George. The area of the estate was 477 acres and 71 cents. Mr. A. V. George had entered into the agreement in his own name and on behalf of another company called the Kailas Rubber Co. Ltd. It was agreed that the vendor would execute the necessary conveyance in favour of Mr. A. V. George or his nominees. On 15th August. 1955. the assessee entered into an agreement with Mr. A. V. George whereby the assessee agreed to purchase 477.71 acres forming part of Kuttikal Estate for Rs. 6 lakhs. An advance of Rs. 1 1,000 was paid by the assessee. The balance of Rs. 5,89,000 was to be paid by the assessee on or before 25th September, 1955. It was agreed that Mr. A. V. George should execute a sale-deed himself or cause it to be executed Kailas Rubber Co. Ltd. on whose behalf he was acting in favour of the assessee or his nominees. The assessee subsequently divided the area of 477.71 acres into 23 plots and found purchasers for 22 of these, plots. The total extent of 22 plots for which he found purchasers was 373.58 acres and the total price paid by the 22 purchasers was Rs. 5,18,500. A sale deed was executed by the Mundakayam Valley Rubber Co. Ltd. on 31st March, 1956. It covered all the 23 plots. The 22 plots for which the assessee found purchasers were conveyed to the respective purchasers and the 23rd plot was conveyed to the assesses himself. Mr. A. V. George and the Kailas Rubber Co. Ltd. were parties to this document. The plot which the assessee had retained for himself was 104.13 acres in extent. Its value was estimated by the Income Tax Officer at Rs. 2,08,000. The Income Tax Officer worked out the profit from the transaction of purchase and sale of land as follows "Sale price of 373 acres Rs. 5,18,500 Value of 104 acres retained by the assessee at Rs. 2,000

per acre... Rs. 2,08,000

	Rs. 7,26,500
Less Cost	Rs. 6,00,000
	Rs. 1,26,500

The Income Tax Officer held that a sum of Rs. 1,25,000 in round figures represented the assessee's profit from an adventure in the nature of trade and included this amount in his total income under section 34(1)(a) of the Act. The assessee appealed to the Appellate Assistant Commissioner who rejected the appeal. The assessee took the matter in further appeal to the Appellate Tribunal which also rejected the appeal holding that the amount of Rs. 1,25,000 represented profit from an adventure in the nature of trade. At the instance of the assessee the Appellate Tribunal stated a case to the High Court on the following question of law "Whether on the facts and in the circumstances of the case, the transactions constituted a venture in the nature of trade and the surplus of Rs. 1,25,000 was assessable to tax By its. judgment dated 10th October, 1966, the High Court of Kerala answered the question in the affirmative and against the assessee. This appeal is brought by special leave from the judgment of the High Court of Kerala, dated 10th October, 1966 in Income Tax Reference No, 18 of 1965, The question whether a transaction is an adventure in the nature of trade must be decided on a consideration of all the relevant facts and circumstances which are proved in the particular case. The answer to the question does not depend upon the application of any abstract rifle or principle or formula but must depend upon the total impression and effect of all the relevant facts and circumstances established in the particular case. In. California Copper Syndicate v. Harris,(1) Lord Justice Clerk, observed "It is quite a well settled principle in dealing with questions of assessment of income tax that where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at the enhanced price is not profit assessable to income tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business. What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being-Is the sum of gain that has been made a mere enhancement of value by realising a security or is it a gain made in the operation of business in carrying out a scheme for profit making ?"

> But in judging the character of such transactions several factors have been treated as significant in decided cases. For instance, if a transaction related to the business which is normally carried on by the assessee, though not directly a 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. The magnitude of the transaction of purchase, the nature of the commodity, the subsequent dealings of the assessee, the nature of the Organisation employed by the assessee and the manner of disposal may be such that, the

transaction may be stamped with the character of a trading nature. In Martin v. Lowry, (2) the assessee purchased a large quantity of aeroplane linen and sold it in different lots, and for the purpose of selling it started an advertising campaign, rented offices engaged an advertising manager, a linen expert and a staff of clerks. maintained account books normally used by a trader, and passed receipts add payment (1) [1904] 5 S.T.C. 159,16-66.

(2) 11 Tax Cases 297.

in connection with the linen through a separate banking account., It was held that the assessee carried on an adventure in the nature of trade and so the profit was liable to be taxed. The same view was taken in Rutledge v. Commissioners of Inland Revenue(1) in regard to an assessee who purchased very cheaply a vast quantity of toilet paper and within a short time thereafter sold the whole consignment at a considerable profit. Similarly, in Commissioner of Inland Revenue v. Fraser (2) the assessee, a woodcutter, bought for resale, whisky in bond, in three 'lots. He sold it later on at considerable profit. The assessee had never dealt in whisky before, he had no special knowledge of the trade he did not take delivery of the whisky nor did he have it blended and advertised. Even so it was held that the transaction was an adventure in the nature of trade. Lord President Normand observed in the course of the judgment :

"It is in general more easy to hold that a single transaction entered into by an individual in the line of his own trade (although not part and parcel of his ordinary business) is an adventure in the nature of trade than to hold that a transaction entered into by an individual outside the line of his own trade or occupation is an adventure in the nature of trade. But what is a good deal more important is the nature of the transaction with reference to the commodity dealt in. The individual who enters into a purchase of an article or commodity may have in view the resale of it at a profit, and yet it may be that is not the only purpose for which he purchased the article of the commodity, nor the only purpose to which he might turn it if favourable opportunity of sale does not occur. In some of the cases the purchase of a picture has been given as an illustration. An amateur may purchase a picture with a view to its resale at a profit, and yet he may recognise at the time or afterwards that the possession of the picture will give him aesthetic enjoyment if he is unable ultimately, or at his chosen time, to realise it at a profit. A man may purchase stocks and shares with a view to selling them at an early date at a profit, but, if he does so, he is purchasing something which is itself an investment, a potential source of revenue to him while he holds it. A man may purchase land with a view to realising it at a profit, but it also may yield him an income while he continues to hold it. If he continues to hold it, there may be also a certain pride of possession But the purchaser of a large quantity of a commodity like whisky, greatly in excess of what could be used by (1) 14Tax Cases490.

(2) 24 Tax Cases 498.

himself, his family and friends, a commodity which yields no pride of possession, which cannot be turned to account except by. a process of realisation, I can scarcely consider to be other than an adventure in a transaction in the nature of a trade; and I can find no single fact among those stated by the Commissioners which in any way traverses that view. In my opinion, the fact that the transaction was not in the way of business (whatever it was) of the respondent in no way alters the character which almost necessarily belongs to a transaction like this".

These are cases of commercial commodities but a transaction of purchase of land cannot be assumed without more to be an adventure in the nature of trade. In Leeming v. Jones,(1) a syndicate was formed to acquire an option over a rubber estate with a view to resell it at a profit, and finding the estate too small the syndicate acquired another estate and sold the two estates on profit. It was held that the transaction was not in the nature of trade and the profit was not liable to be assessed to tax. The same view was expressed in Saroj Kumar Mazumdar v. Commissioner of Income Tax (2) in which the assessee who carried on business of engineering works purchased land, which was under

> requisition by the Government, negotiated a sale before the land was de-requisitioned and sold it after the land was released. But the circumstances of a particular case may lead to the conclusion that the purchaser resale of land is in the nature of trade. In Venkataswami Naidu & Co. v. Commissioner of Income Tax(3) the appellant firm which acted as managing agents purchased, for a total consideration of Rs. 8,713, four contiguous plots of land adjacent to the place where the mills of the company managed by it were situated. The first purchase was made in October, 1941 and subsequent Purchases were made in November, 1941, June 1942 and November, 1942. As long as the appellant was in possession of the land it made no effort to cultivate it or erect any superstructure on it but allowed the land to remain unutilised except for the rent received from the house which existed on one of the plots. The appellant sold the land to the company managed by it in two lots in September and November, 1947, for a total consideration of Rs. 52,600. The question was whether the sum of Rs. 43,887 being the excess realised by the appellant by the two sales over its purchase price, was assessable to income-tax. The Appellate Tribunal rejected the contention of the appellant that the properties were bought as an investment and that the plots were acquired for building tenements for the labourers or the mills but came to the conclusion that the transaction was an adventure in the nature (1) 15 Tax Cases 333.
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> (2) 37 1,T.R, 242, (3) 351.T.R. 594, of trade. On a reference the High Court expressed the same view. It was held by this Court in appeal that- the Appellate Tribunal was right in inferring that the appellant knew that it would be able to sell the lands to the' 'managed company whenever it thought it profitable, so to do, that the appellant purchased the four plots of land with the sole intention of selling them to the mills at a profit and that the High Court was right in holding that the tran-

saction was an adventure in the nature of trade. gain in Raja J. Rameshwar Rao v. Commissioner of Income-tax Hyderabad,(1) the assessee purchased 217 acres of land from the pattadars and on a

portion of the land the assessee constructed a Ganj and shops. The rest of the land he laid out as plots which he sold for a sum of Rs. 75,820. In computing the assessable income the Income Tax Officer added a sum of Rs. 75,820 as receipt from business. The decision of the Income Tax Officer was affirmed by the Appellate Commissioner and the Tribunal in appeal. The High Court held on a reference by the, Appellate Tribunal that there was evidence upon which, the Appellate Tribunal could have come to the conclusion that the sum of Rs. 75,820 was the assessee's income from business. It was held by this Court on appeal that when a person acquired land with a view to selling it later after developing it, he, was carrying on an activity resulting in profit, and the activity can only be described as a business venture. Where the person goes further and divides the land into plots, develops the area to make it more attractive and sells the land not as a single unit and as he bought it, but in parcels, he is dealing with land as his stock-in-trade. The decision of the High Court was accordingly affirmed and the appeal to this Court was dismissed.

As we have already said it is not possible to evolve any single legal test or formula which can be applied in determining whether a transaction is an adventure in the nature of trade or not. The answer to the question must necessarily depend in each case on the total impression and effect of all the relevant factors and circumstances proved therein and which determine the character of the transaction. What. then are the material facts found in the present case ?

It is clear from the recital of the agreement dated 15th October, 1955 that the intention of the assessee in purchasing the estate was to resell it at a profit. An advance of Rs. 11,000 was paid by the assessee on that date the balance of Rs. 5,89,000 was to be paid on or before 25th September, 1955. It was one of the terms of the agreement that Mr. A. V. George was to execute the sale deed either in favour of the assessee or his nominees. It was also found that the assessee did not have the resources to buy any estate worth a lakh of rupees when he entered into the agreement for the purchase of Kuttikal Estate for an amount of (1) 42 I.T.R. 179.

Rs. 6 lakhs. In the intervening period between '15th August, 1955 and 31st March, 1956 the assessee divided the estate into 23 plots and arranged for the sale of 22 plots to different purchasers. The division of the land into 23 plots and the sale to the various purchasers indicate that there was scheming and Organisation on the part of the assessee. It was found that the assessee did not have the means and resources to cultivate the land himself and that he had arranged for the sale of 22 plots to different purchasers. Having regard to the total effect of all these circumstances we are of the opinion that the High Court was right in its conclusion that the transactions of the assessee constituted an adventure in the nature of trade and were in the course of a profit making scheme and the, question was rightly answered by the High Court against the assessee.

It was then contended on behalf of the appellant that even assuming that there was an adventure in the nature of trade,' the profits from such an adventure have not been properly ascertained in the present case. It was said that the Income-tax authorities were wrong in holding that the value of the 23rd plot retained by the assessee represented the profit made in the transaction. The argument was that the adventure would terminate after the portion retained by the appellant was also sold and therefore the profits in the adventure could be determined only at the time of the completion of the sale of the entire estate. In our opinion, there is no justification for this argument. It is not a correct

proposition to say that the profits of the assessee cannot be ascertained even on the assumption that the transaction of the adventure of trade was not completed. Under the Income Tax Act for the purpose of assessment each year is a self-contained unit and in the case of a trading adventure the profits have to be computed in the manner provided by the statute. It is true that the Income Tax Act makes no express provision with regard to the value of stock. It charges for payment of tax the income profits and gains which have to be computed in the manner provided by the Income Tax Act. In the case of a trading adventure the profits have to be calculated and adjusted in the light of the provisions of the Income Tax Act permitting allowances prescribed thereby. For that purpose it was the duty of the Income Tax Officer to find out what profit the business has made according to the true accountancy practice. As a normal rule, the profit should be ascertained by valuing the, stock-in-trade at the beginning and at the end of the accounting year. In Whimster & Co. V. Commissioner of Inland Revenue(1) Lord President Clyde observed at page 823 :

> "In computing the balance of profits and gains for the purposes of income-tax.... two general and fundamental common places have already to be kept in mind.
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> (1) 12 Tax Cases 813.

In the first place, the profits of any particular year or accounting period must be taken to consist of the difference between the receipts from the trade or business during such year or accounting period and the expenditure laid out to earn those receipt. In the second place, the account of profit and loss to be made up for the purpose of ascertaining that difference must be framed consistently with the ordinary principles of commercial accounting, so far as applicable, and in conformity with the rules of the income Tax Act, or of that Act as modified by the provisions and schedules of the Acts regulating excess profits duty, as the case may be. For example, the ordinary principles of commercial accounting require that in the profit, and loss account of a merchant's or manufacturer's business the values of the stock-in-trade. at the beginning and at the end of the period covered by the account should be entered at cost or market price, whichever is the lower; although there is nothing about this in the taxing statutes". In Commissioners of Inland Revenue v. Cock, Russell & Co. Ltd.(1) Croom-Johnson, J. in dealing with valuation of stock-in-trade for purposes of taxation stated as follows:

> "There is no word in the statutes or rules which deals with this question of valuing stock-in-trade. There is nothing in the relevant legislation which indicates that in computing the profits and gains of a commercial concern the stock-in-trade at ' the start of the accounting period should be taken in and that the amount of the stock-in-trade at the, end of the period should also be taken in. It would be fantastic not 'Lo do it : it would be utterly impossible accurately to assess profits and gains merely on a statement of receipts and payments or on the basis of turnover. It has long been recognised that the right method of assessing profits and gains is to take into account the value of the stock-in-trade at the beginning and the value of the stock-in-trade at the end as two of the items in the computation. I need not cite authority for the general proposition which is admitted at the Bar, that for the purposes of ascertaining profits and gains the ordinary principles of commercial

accounting should be applied, so long as they do not conflict with any express provision of the relevant statutes."

In Commissioner of Income-tax, Madras v. A. Krishnaswami Mudaliar and Ors. (2) it was observed by this Court that which ever method of book keeping was adopted in the case of a trading (1) 29 Tax Cases 387 (2) 53 I.T.R. 122.

venture for computing the true profits of the year the stock-in-trade must be taken into account. At page 132 of the report Shah, J. speaking for the Court stated the principle as follows "These observations do not affect the true character of the profit of a business.

Adjustments may have to be made in the principle having regard to the special cha- racter of the assets the nature of the business and the appropriate allowances permitted, in order to arrive at the taxable profits. They do not support the proposition that, in the case of a trading venture, you can arrive at the true profits of a year by ignoring altogether the valuation of the stock-in-trade at the end of the year, while debiting its value at the commencement of the year as an outgoing; for determination of the profits by ignoring the valuation of the. stock at the end of the year and debiting the value of the assets at the commencement of the year would not give a true picture of the profit for the year of account".

In view of this principle we are of the opinion that the Income-tax authorities have correctly estimated the profit of the assessee by treating the land as stock-in-trade and valuing it according to the normal accountancy practice. For the reasons expressed we hold that the decision of the High Court of Kerala, dated 10th October, 1966, is correct and this appeal must be dismissed with costs. Y.P. Appeal dismissed