Commissioner Of Income Tax, Mumbai vs D.P. Sandu Bros. Chembur (P) Ltd on 31 January, 2005

Equivalent citations: AIR 2005 SUPREME COURT 796, 2005 AIR SCW 778, 2005 AIR - JHAR. H. C. R. 873, 2005 TAX. L. R. 572, (2005) 27 ALLINDCAS 630 (SC), (2005) 142 TAXMAN 713, (2005) 2 JT 226 (SC), 2005 (2) SLT 78, 2005 (1) SCALE 661, 2005 (2) SCC 584, 2005 (27) ALLINDCAS 630, (2005) 3 ALLMR 545 (SC), (2005) 1 SCALE 661, (2005) 193 CURTAXREP 578, (2005) 273 ITR 1, (2005) 1 SCJ 790, (2005) 185 TAXATION 471, (2005) 1 SUPREME 666, 2005 (2) BOM LR 598, 2005 BOM LR 2 598

Author: Ruma Pal

Bench: Ruma Pal, Arijit Pasayat, C.K. Thakker

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           CASE NO.:
Appeal (civil)  2335 of 2003

PETITIONER:
Commissioner of Income Tax, Mumbai

RESPONDENT:
D.P. Sandu Bros. Chembur (P) Ltd.

DATE OF JUDGMENT: 31/01/2005

BENCH:
Ruma Pal,Arijit Pasayat & C.K. Thakker

JUDGMENT:
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J U D G M E N T RUMA PAL, J.

The primary question involved in this appeal is whether the amount received by the respondent-assessee on surrender of tenancy rights is liable to capital gains tax under Section 45 of the Income tax Act, 1961. The assessment year in question is 1987-88. The lease agreement was entered in 1959 for 50 years under which an annual rent was paid by the lessee to the lessor. The lease would have continued till 2009. During the relevant previous year, in March 1986, the respondent surrendered its tenancy right to its lessor prematurely. In consideration for such premature termination, the lessor paid the lessee a sum of Rs. 35 lakhs.

In the assessee's return the sum of Rs.35 lakhs had been credited to its reserve and surplus account. This was disallowed by the Assessing Officer who held that the amount of Rs.35 lakhs was taxable as "income from other sources" under Section 10(3) read with Section 56. The assessee appealed to the

Commissioner of Income Tax (Appeals) who came to the conclusion that the assessee was liable to pay capital gains on the amount of Rs. 35 lakh after deducting an amount of Rs.7 lakhs as the cost of acquisition. The Commissioner had determined the cost of acquisition at Rs. 7 lakhs on the basis of the market value of the property as on 1.4.1974. Both the Department and the assessee challenged the decision of the Commissioner before the Tribunal.

The Tribunal relied upon the decision of this Court in Commissioner of Income Tax V. Srinivasa Setty 128 ITR 294 = (1981) 2 SCC 460 as well as the amendment to Section 55(2) of the Act in 1995 and held that the assessee did not incur any cost to acquire the leasehold rights and that if at all any cost had been incurred it was incapable of being ascertained. It was therefore held that since the capital gains could not be computed as envisaged in Section 48 of the Income Tax Act, therefore capital gains earned by the assessee if any was not exigible to tax.

The Department preferred an appeal before the High Court. The High Court dismissed the appeal. Being aggrieved by the decision of the High Court, this further appeal has been preferred by the Department.

The Department has contended that the surrender value of the tenancy rights was chargeable to capital gains under Section 45 of the Act. If not, it was liable to be taxed as 'income from other sources' under Section 10(3) read with Section 56 of the Act.

Section 2(24)(vi) defines 'income' as including "any capital gains chargeable under Section 45". Section 45 provides that any profits or gains arising from the transfer of a capital asset effected in the previous year is chargeable to income tax under the head 'capital gains' and is deemed to be the income of the previous year in which the transfer took place, subject to certain exceptions which are not material in this case. Section 48 provides for the mode of computation of income chargeable under the head 'capital gains'. The method of computation prescribed is by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset, certain prescribed amounts including the cost of acquisition of the assets and the cost of any improvement thereto.

That the tenancy right is a capital asset, the surrender of the tenancy right is a "transfer" and the consideration received therefore a capital receipt within the meaning of Section 45 has not been questioned before us and must in any event be taken to be concluded by the decision of this Court in A. Gasper v. Commissioner of Income Tax . Normally the consideration would therefore be subjected to capital gains under Section 45. In 1981 this Court in Commissioner of Income Tax V. B.C. Srinivasa Setty held that all transactions encompassed by Section 45 must fall within the computation provisions of Section 48. If the computation as provided under Section 48 could not be applied to a particular transaction, it must be regarded as "never intended by Section 45 to be the subject of the charge". In that case, the Court was considering whether a firm was liable to pay capital gains on the sale of its goodwill to another firm. The Court found that the consideration received for the sale of goodwill could not be subjected to capital gains because the cost of its acquisition was inherently incapable of being determined. Pathak J. as his Lordship then was, speaking for the Court said:

> "What is contemplated is an asset in the acquisition of which it is possible to envisage a cost. The intent goes to the nature and character of the asset, that it is an asset which possesses the inherent quality of being available on the expenditure of money to a person seeking to acquire it. It is immaterial that although the asset belongs to such a class it may, on the facts of a certain case, be acquired without the payment of money."

In other words, an asset which is capable of acquisition at a cost would be included within the provisions pertaining to the head 'capital gains' as opposed to assets in the acquisition of which no cost at all can be conceived. The principle propounded in Srinivasa Setty has been followed by several High Courts with reference to the consideration received on surrender of tenancy rights. [See: Among others Bawa Shiv Charan Singh Vs. Commissioner of Income Tax, Delhi (1984) 149 ITR.29; The Commissioner of Income Tax Vs. Mangtu Ram Jaipuria (1991) 192 ITR 533(Cal.); Commissioner of Income Tax Vs. Joy Ice Cream (Bang) Pvt. Ltd. (1993) 2001 ITR 895(Kar.) Commissioner of Income Tax Vs. Markapakula Agamma (1987) 165 ITR 386 (A.P.); Commissioner of Income Tax Vs. Merchandisers (P) Ltd. (1990) 182 ITR 107) (Ker.)] . In all these decisions the several High Courts held that if the cost of acquisition of tenancy rights cannot be determined, the consideration received by reason of surrender of such tenancy rights could not be subjected to capital gains. According to a Circular issued by the Central Board of Direct Taxes it was to meet the situation created by the decision in Srinivasa Setty and the subsequent decisions of the High Court that the Finance Act 1994 amended Section 55 (2) to provide that the cost of acquisition of inter-alia a tenancy right would be taken as nil. By this amendment, the judicial interpretation put on capital assets for the purposes of the provisions relating to capital gains was met. In other words the cost of acquisition would be taken as determinable but the rate would be nil.

The amendment took effect from 1st April 1995 and accordingly applied in relation to the assessment year 1995-96 and subsequent years. But till that amendment in 1995, and therefore covering the Assessment Year in question, the law as perceived by the Department was that if the cost of acquisition of a capital asset could not in fact be determined, the transfer of such capital asset would not attract capital gains. The appellant now says that Srinivasa Setty's case would have no application because a tenancy right cannot be equated with goodwill. As far as goodwill is concerned, it is impossible to specify a date on which the acquisition may be said to have taken place. It is built up over a period of time. Diverse factors which cannot be quantified in monetary terms may go into the building of the goodwill, some tangible some intangible. It is contended that a tenancy right is not a capital asset of such a nature that the actual cost on acquisition could not be ascertained as a natural legal corollary.

We agree. A tenancy right is acquired with reference to a particular date. It is also possible that it may be acquired at a cost. It is ultimately a question of fact. In A.R. Krishnamurthy and Ors. v. Commissioner of Income Tax, Madras (1989) 176 ITR 417 this Court held that it cannot be said conceptually that there is no cost of acquisition of the grant of the lease. It held that the cost of acquisition of leasehold rights can be determined. In the present case however, the Department's stand before the High Court was that the cost of acquisition of the tenancy was incapable of being ascertained. In view of the stand taken by the Department before the High Court, we uphold the

decision of the High Court on this issue. Were it not for the inability to compute the cost of acquisition under Section 48, there is, as we have said, no doubt that a monthly tenancy or leasehold right is a capital asset and that the amount receipt on its surrender was a capital receipt. But because we have held that Section 45 cannot be applied, it is not open to the Department to impose tax on such capital receipt by the assessee under any other Section. This Court, as early as in 1957 had, in United Commercial Bank Ltd. V. Commissioner of Income Tax Ltd., West Bengal (1957) 32 ITR 688, held that the heads of income provided for in the Sections of the Income Tax Act, 1922 are mutually exclusive and where any item of income falls specifically under one head, it has to be charged under that head and no other. In other words, income derived from different sources falling under a specific head has to be computed for the purposes of taxation in the manner provided by the appropriate Section and no other. It has been further held by this Court in East India Housing and Land Development Trust Ltd. V. Commissioner of Income Tax, West Bengal (1961) 42 ITR 49 that if the income from a source falls within a specific head, the fact that it may indirectly be covered by an another head will not make the income taxable under the latter head. (See also: Commissioner of Income Tax Vs. Chugandas and Co.(1964) 55 ITR 17).

Section 14 of the Income Tax Act 1961 as it stood at the relevant time similarly provided that "all income shall for the purposes of charge of income tax and computation of total income be classified under six heads of income," namely; (A) Salaries;

(B) Interest on Securities;

(C) Income from house property;

(D) Profits and gains and business or profession; (E) Capital gains;

(F) Income from other sources unless otherwise, provided in the Act.

Section 56 provides for the chargeability of income of every kind which has not to be excluded from the total income under the Act, only if it is not chargeable to income tax under any of the heads specified in Section 14 items A to E. Therefore, if the income is included under any one of the heads, it cannot be brought to tax under the residuary provisions of Section 56.

There is no dispute that a tenancy right is a capital asset the surrender of which would attract Section 45 so that the value received would be a capital receipt and assessable if at all only under Item E of Section 14. That being so, it cannot be treated as a casual or non recurring receipt under Section 10(3) and be subjected to tax under Section 56. The argument of the appellant that even if the income cannot be chargeable under Section 45, because of the inapplicability of the computation provided under Section 48, it could still impose tax under the residuary head is thus unacceptable. If the income cannot be taxed under Section 45, it cannot be taxed at all. (See: S.G. Mercantile Corporation (P) Ltd. Vs. Commissioner of Income Tax, Calcutta (1972) 83 ITR 700).

Furthermore, it would be illogical and against the language of Section 56 to hold that everything that is exempted from capital gains by statute could be taxed as a casual or non recurring receipt under

Section 10(3) read with Section 56. We are fortified in our view by a similar argument being rejected in Nalinikant Ambalal Mody Vs. S.A.L. Narayan Row CIT (1966) 61 ITR 428,432,435.

The appeal is accordingly dismissed without any order as to costs.