Travancore Rubber And Tea Co. Ltd vs Commissioner Of Income Tax, Trivandrum on 14 March, 2000

Equivalent citations: AIR 2000 SUPREME COURT 1980, 2000 (3) SCC 715, 2000 AIR SCW 1063, (2000) 3 JT 458 (SC), 2000 (2) SCALE 409, 2000 (4) LRI 83, 2000 (4) SRJ 355, 2000 (3) JT 458, (2000) 2 KER LT 25, (2000) 109 TAXMAN 250, (2000) 160 RECCRIR 1, (2000) 243 ITR 158, (2000) 157 TAXATION 299, (2000) 2 SUPREME 514, (2000) 2 SCALE 409

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Bench: D.P. Wadhwa, Ruma Pal

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           CASE NO.:
Appeal (civil)  385-386 of 1999

PETITIONER:
TRAVANCORE RUBBER AND TEA CO. LTD.

RESPONDENT:
COMMISSIONER OF INCOME TAX, TRIVANDRUM

DATE OF JUDGMENT: 14/03/2000

BENCH:
D.P. WADHWA & RUMA PAL

JUDGMENT:
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JUDGMENT 2000 (2) SCR 290 The Judgment of the Court was delivered by RUMA PAL, J. The assessment year in question is 1977-78. The issue is whether the amounts received by the assessee/appellant in respect of an abortive sale transaction of rubber trees are capital or revenue receipts? The assessee is a plantation company engaged in the business of growing rubber and tea. In 1975, it entered into three agreements with three purchasers for sale for old rubber trees. Each of the purchasers paid a certain amount by way of earnest money and another amount by way of advance under their respective agreements. The total amount of earnest money received by the assessee under the three agreements was Rs. 75,000 and the total amount by way of advance was Rs. 3,56,300. All the three purchasers defaulted in payment of the balance amounts. The agreements were accord- ingly terminated and the amounts of earnest money and advance were forfeited by the assessee. The assessee filed three suits before the Subordi-nate Judge, Kottayam in this connection. The assessee's right to retain the amounts of earnest money and advance was confirmed by the Court. In 1979, the assessee was eventually successful in selling the old rubber trees to a third party but at a loss.

In the assessee's return for the assessment year in question, the assessee claimed that the amounts forfeited were not taxable as revenue receipts. The Assessing Officer upheld the contention of the assessee. However, the Commissioner of Income Tax sought to revise the assessment under Section 263 of the Act and held that the amounts forfeited were revenue income and assessable to income tax. The assessee preferred an appeal before the Income Tax Appellate Tribunal. The Tribunal set aside the order of the Commissioner and restored the finding of the Assessing Officer.

At the instance of the Revenue, the Income Tax Appellate Tribunal referred the following two questions of law for the decision of the High Court under Section 256(1) of the Act :

> (1) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the sum of Rs. 3,95,229 cannot be considered to be a revenue receipt in the hands of the assessee?
>
> (2) Whether on the facts and in the circumstances of the case, the Tribunal was justified in finding that the sum of Rs. 3,95,229 is not the income of the assessee for this assessment year and directing the Income Tax Officer to modify the assessment?

The High Court's decision (which has been subsequently reported in 1991 Vol. 190 ITR 509 - Commissioner of Income Tax v. Travancore Rubber and Tea Co. Ltd. was that the Tribunal should have kept in mind the difference between earnest money and advance while deciding the issues raised. The High Court delineated the difference between the legal character of the two amounts and remanded the matter back to the Income Tax Appellate Tribunal to decide the matter afresh.

On remand, the Tribunal considered various terms of the agreements and came to the conclusion that the receipt by way of forfeiture of advance was not assessable as a revenue receipt but that the earnest money was so assessable as income under other sources.

At the instance of both the assessee as well as the Revenue, the following questions were referred by the Tribunal to the High Court of Kerala for its opinion :

> At the instance of the assessee.
>
> (1) Whether on the facts and in the circumstances of the case the Tribunal was right in law in holding that the earnest money deposit of Rs. 75,000 received by the assessee in respect of the agreements for sale of old and uneconomic rubber trees is revenue income assessable to income-tax when forfeited consequent to termination of the said agreements for breach thereof by the purchasers.

At the instance of the Department :

> (2) Whether, on the facts and in the circumstances of the case, the Tribunal is right in law and fact in holding that the receipt by way of forfeiture of advance amount arising to the assessee, -

(a) is a benefit arising to the assessee in the course of its plantation business?

(b) is not or cannot be subject to tax?

(3) Whether, on the facts and in the circumstances of the case and in view of the fact that the trees were transferred i.e. cut and removed ultimately by agreement dt. 22.7.1979, the tribunal is, -

(i) factually incorrect in holding that "it is an undisputed fact that the trees had not been been cut and removed or at least there is no evidence.....?

(ii) legally and factually right in "rejecting the contention" of the Revenue after having rightly accepted the conten-tion of the Revenue that the receipt would be exigible to income-tax for capital gains?

(4) Whether, on the facts and in the circumstances of the case if the answer to question No. 2 is in favour of the Revenue should not the Tribunal have in view of the provisions contained in Section 51 of the Income Tax Act and read with the decision of the Supreme Court in 131 ITR 451 given appropriate direction to the assessing authority?"

The High Court by its judgment dated 9th April 1995 answered the first question only. It held that both the amounts received by the assessee by way of forfeiture could not be considered in relation to "any other thing other than the situation of forfeiture" and once it is held that forfeiture puts an end to the agreement in question as a necessary sequitur, it followed that it "puts an end to the character as is understood by the parties and to the amounts covered thereby" and that the amounts in question were income receipts in the context of the situation. Adverting to Section 51 of the Act, the High Court was of the view that the factual situation envisaged under Section 51 was absent in the assessee's case, that the amounts that were with the assessee after forfeiture could not "be said to have been retained by the assessee in respect of the transaction"

and finally, that application of Section 51 "is contemplated or can be thought of at a stage prior to the execution of the agreement in question, at a stage of negotiation deal with receipt of advance or other money and retention thereof."

We are, unfortunately, unable to accept the reasoning or the conclusion of the High Court. The assessee does -lot carry on the business of selling trees. The question whether the sale proceeds of old and unyielding rubber trees grown and used for obtaining income as latex therefrom are capital receipt and whether the sale proceeds of unyielding trees purchased many years back as yielding trees are capital receipt was answered in the affirmative by the Constitution Bench of this Court in Commissioner of Agricultural Income Tax, Kerala v. Kailas Rubber & Co. Ltd., (1966) Vol. 60 ITR 435. See also AKTM Vishnudatta Anantharjanam v. Commissioner of Agricultural Income Tax, Trivandrum, (1970) 78 ITR 58.

When the assessee entered into the three agreements for sale of old and unyielding rubber trees what was received by way of advance consideration was, therefore, capital receipt. Had sale gone through there would be no question but that the consideration would be subject to capital gains. The question is does the character of the receipt change because the sale was not subsequently effected?

Learned counsel for the assessee relied on Morley (inspector of Taxes) v. Tattersall, (1939) 7 ITR 316; (followed in Commissioner of Income Tax v. Motor & General Insurance Ltd., 94 ITR 582 (Del) (DB); Commissioner of Income Tax, Tamilnadu v. AVM Ltd. 146 ITR 355) to contend that the question and nature of a receipt for income tax purposes were fixed once and for all when the subject of the receipt was received and that no subsequent operation could change the nature of the receipt.

Learned counsel for the respondent countered the agreement and cited Commissioner of Income Tax v. Karam Chand Thapar, [1996] 10 SCC 577 where this Court noted the decisions in Jay's The Jewellers Ltd. v. IRC, 29 Tax Cases 274 : (1947) 2 All ER 762 and Elson (Inspector of Taxes) v. Prices Tailors Ltd., (1963) 1 All ER 231 with approval as limiting the principle enunciated in Tattersall's case. It was held by this Court that the proposition enunciated in Tattersall's case was not absolute and that in given cases amounts which were not received initially as trading receipts could eventu-ally be regarded as business income by reason of subsequent events. The subsequent event must be such that 'a different quality is imprinted' on the receipt. An example of such subsequent even was found in the case of Joy's The Jewellers (supra) where :

> "It has been categorically laid down that the money, which belonged to the customers and which arose out of sale of customer's property could become a trading receipt when the customers did not or could not make any claim against that money in law and amount was taken by the assessee to its profit and loss account. In fact, it was emphasised that that was the correct accounting practice. Atkinson, J. pointed out that a new asset could come into existence automati-cally by operation of law. When no demand for payment was made common sense requires that such amount should be entered into profit and loss account for the year and be treated as taxable."

However, in our view, the cancellation of a sale of capital assets would not be such a subsequent event so as change the nature of the receipt of the forfeited amounts.

The specific provisions of Section 51 of the Income Tax Act, 1961 which provide for the computation of the cost of acquisition for determining the capital gains arising from the transfer of a particular asset fortify this view. Section 51 reads :

> "57. Advance money received. - Where any capital asset was on any previous occasion the subject of negotiations for/its transfer, any advance or other money received and retained by the assessee in respect of such negotiations shall be deducted from the cost for which the asset was acquired or the written down value or the fair market

> value, as the case may be, in computing the cost of acquisition."

(emphasis added) Thus where there is a transfer of a capital asset, if there was a previous occasion when there were negotiations for its transfer, and if "advance or other money" had been received and retained by the assessee in respect of such negotiations, such amounts will in effect be added to the value of the capital asset impacting on the ultimate assessment of capital gains. For this purpose, no distinction is made between moneys received and retained by way of 'advance' and 'other money'. The phrase 'other money' would cover, for example, deposits made by the purchaser for guaranteeing due perform-ance of the contracts and not forming part of the consideration. The monies received on the previous occasions and retained by the vendor/assessee cannot therefore, be treated as a revenue receipt. Section 51 to the extent stated thus preserves the rule in Tattersall's case.

In the case before us there were negotiations for transfer of the rubber trees in question, which did not fructify in sale. The amounts forfeited referred only to the capital asset of the assessee and-were directly related to the sale of such capital asset. The Tribunal correctly held that the advance money for sale of the rubber trees formed part of the capital asset of the assessee and that the sale, if materialised, would have resulted in a gain exigible to capital gains tax, provided there is a gain arising out of the same. But the Tribunal erred in overlooking the phrase 'or other money' in Section 51 in holding that the earnest money did not come within the purview of Section 51. No doubt, as held by the High Court in the decision reported in (1990) Vol. 190 ITR 509 (supra), there is a distinction between earnest money and advance, but that distinction loses its significance in the context of the express language of Section 51 to include 'other money' in addition to 'advance.' The matter may be considered from another aspect. The amount forfeited by the assessee was in terms of clause 16 of the agreement which reads :

> "It the event of the Purchaser failing to pay any of the instalments hereby agreed to be paid by him on the date specified or violating any of the terms on its part to be performed, the Vendor shall have the right and liberty to cancel all rights hereby granted to the Purchaser any time after such violation and to realise from the Purchaser forthwith in a lump the entire balance amount then remaining to be paid. In the event of the balance amount remaining unpaid on demand the purchaser will not have any claim or right over the Rubber Trees standing or cut nor can he claim from the Vendor the earnest money deposit or the instalments paid till date. "

(emphasis added) Such a clause has been construed as providing for compensation for breach of contract under Section 74 of the Indian Contract Act, 1872. [See Maula Bux v. Union of India, AIR (1970) SC 1955 and Shree Hanuman Cotton Mills and Another v. Tata Air Craft Ltd., AIR (1970) SC 1986.] In determining whether compensation received for breach of a contract is a capital or trading receipt, the relevant rule has been formulated by Diplock L., J. in London and Thames Haven Oil Wharves Ltd. v. Attwooll (Inspector of Taxes) (1968) 70 ITR 460 at p.488 as :

> "Where, pursuant to a legal right, a trader receives from another person compensation for the trader's failure to receive a sum of money which, if it had been

> received, would have been credited to the amount of profits (if any) arising in any year from the trade carried on by him at the time when the compensation is so received, the compensation is to be treated for income tax purposes in the same way as that sum of money would have been treated if it had been received, instead of the compensation."

The logic of the principle is that the assessee's right to recover the compensation was to place the assessee in the same position as if the breach had not taken place. Applying the rule to this case, if the agreed sums of money under the agreements had been received by the assessee, they would have been credited in its account as a capital receipt. That being so, the forfeited amounts must also be treated as capital receipt.

Finally, the High Court erred in proceeding on the basis that the agreements in question were agreements for sale but did not effect a sale. The terms of the agreements clearly show that they were agreements of sale were both payment of the price and delivery were deferred. Had the purchasers paid the purchase price in the agreed instalments their right to take delivery of the trees under the agreement was complete.

For the reasons aforesaid, we allow the appeals and set aside the order of the High Court and answer the question referred to it by the assessee in the negative. There will be no order as to costs.