Thiru Arooran Sugars Ltd., Madras vs The Commissioner Of Income-Tax, Madras on 30 July, 1997

Equivalent citations: AIR 1997 SUPREME COURT 3575, 1997 AIR SCW 3682, 1997 TAX. L. R. 929, (1997) 7 JT 165 (SC), (1997) 93 TAXMAN 579, 1997 (4) COM LJ 1 SC, 1997 (5) SCALE 284, 1997 (6) SCC 606, 1998 BRLJ 71, 1998 (1) UPTC 369, (1997) 5 SCALE 284, (1997) 227 ITR 432, (1997) 7 SUPREME 256, (1997) 140 TAXATION 564, (1997) 142 CURTAXREP 9

Bench: Suhas C. Sen, S.P. Kurdukar

PETITIONER:
THIRU AROORAN SUGARS LTD., MADRAS

Vs.

RESPONDENT:
THE COMMISSIONER OF INCOME-TAX, MADRAS

DATE OF JUDGMENT: 30/07/1997

BENCH:
SUHAS C. SEN, S.P. KURDUKAR

ACT:

HEADNOTE:

JUDGMENT:

W I T H (C.A. No. 6636/83, 6637/83, 6638/83M 6639/83, 6640/83, SLP (C) No. 2611/88, C.A. No. 2399/89, 175-77/85 & 3674/89) J U D G M E N T Sen, J.

The assessment years in this group of appeals (C.A. No. 6636/83, 6637/83, 6638/83M 6639/83, 6640/83, & 175-77/85) are 1962-63 to 1967-68. The assessee-company, Thiru Arooran Sugar Ltd., is a manufacturer of sugar which purchases sugarcane from the market for crushing. It also has its own cane fields where it cultivates sugarcane which is entirely consumed by its factory. Since the profits made by the assessee from the sale of sugar arises out of agricultural activities as well as the manufacturing activities, the income earned by the assessee has to be divided into two parts. No tax

is leviable under the Income Tax Act on agricultural income but the profit generated by the non-agricultural activities is liable to be taxed under the Act. There is no dispute that the income attributable to the agricultural activities must be excluded from the income earned by the assessee from the sale of sugar. But the problem is of computation of such income.

Section 10(1) of the Income-tax Act lays down that the agricultural income shall not be taken into computation of the total income of a previous year of any person under the Income-tax Act, 1961. Section 295 of the Act which empowers the Board to make rules for carrying out the purposes of this Act has specifically empowered the Board by sub-section (2)(b) of Section 295 to frame Rules for the manner in which and the procedure by which the income shall be arrived at in the case of, inter alia, income derived in part from agriculture and in part from business. In exercise of this power Rule 7 of the Income-tax Rules, 1962 was framed which lays down :

"Income which is partially agricultural and partially from business -

(1) In the case of income which is partially agricultural income as defined in section 2 and partially income chargeable to income-tax under the head "Profits and gains of business", in determining the part which is chargeable to income-

tax the market value of any agricultural produce which has been raised by the assessee or received by him as rent-in-kind and which has been utilised as a raw material in such business or the sale receipts of which are included in the accounts of the business shall be deducted, and no further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent-in-kind.

(2) For the purposes of sub-rule (1) "market value" shall be deemed to be -

(a) Where agricultural produce is ordinarily sold in the market in its raw state, or after application to it of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render it fit to be taken to market, the value calculated according to the average price at which it has been so sold during the relevant previous year;

(b) Where agricultural produce is not ordinarily sold in the market in its raw state or after application to it of any state or after application to it of any process aforesaid, the aggregate of

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(i) the expenses of cultivation;

(ii) the land revenue or rent paid for the area in which it was grown;

and

(iii) such amount as the (Assessing) Officer finds, having regard to all the circumstances in each case, the represent a reasonable profit."

Sub-rule (1) of Rule 7 lays down that market value of the agricultural produce raised by the assessee will have to be deducted from the business account of the assessee. The `market value' spoken of in sub-rule (1) will have to be determined in the manner laid down in sub-rule (2). Sub-rule (2) lays down in clause (a) the well-known formula of average price of the goods ordinarily sold in the market as market value of the goods. The formula contained in clause

(b) will only apply in cases where agricultural produce is not ordinarily sold in the market in its raw state or after any process applied to it to make it marketable.

The assessee's contention is that the market value of the sugarcane which has been produced and consumed by the assessee must be determined in the manner laid down n sub- rule (2)(b) of Rule 7. The contention of the Revenue is that the procedure laid down in clause (a) of sub-rule (2) will be the right procedure to follow. The Tribunal was of the view that the procedure laid down in clause (b) had to be resorted to because the price of sugar was controlled by the Sugarcane Control Order at the material time. The High Court was of the view that the Sugarcane Control Order notwithstanding there was a market for sugarcane and even if the assessee consumes the entire quantity of sugarcane raised by it the market price of such sugarcane is ascertainable and this price of such sugarcane is ascertainable and this price has to be excluded from profits and gains of business of the assessee.

The Tribunal found that the assessee Company had grown sugarcane in its own land as well as lands taken on lease. Since the crushing capacity of the assessee's factory was 1200 tons per day, the sugarcane grown by the assessee was not adequate for its requirement. It had, therefore, purchased sugarcane from other growers. The sugarcane purchased by the assessee was much more than the sugarcane produced by it for the assessment years 1962-63, 1966-67 and 1967-68. The assessee purchased sugarcane from the registered ryots according to the provisions of the Sugarcane Control Order and also from non-registered ryots. The quantity of sugarcane purchased from the non-registered ryots was negligible compared to the quantity of sugarcane purchased from the registered ryots except during the periods relevant for assessment years 1962-63, 1963-64 and 1966-67. The Tribunal was of the view that sugarcane could not be treated as agricultural produce ordinarily sold in the market during the relevant previous years. Therefore, it upheld the contention made on behalf of the assessee-company that sugarcane produced by it had to be valued in accordance with Rule 7(2)(b).

The High Court took a contrary view. The High Court took not of the fact that for some of the years under consideration in this case the average cost of cultivation shown by the assessee was more than the average cost of purchase. The assessee was really trying in those years to get deductions of a higher figure than the market value of the sugarcane produced by it. The High Court pointed out that the Tribunal had not come to a finding of fact that sugarcane was not ordinarily sold in the market in its raw state in the area where the factory of the assessee was located. Sugarcane, as a matter of fact, was sold in the market in raw state, even before the Sugarcane Control Order came

into force. Because of the Control Order, sugarcane did not cease to be a produce ordinarily sold in the market. The Control Order merely regulated the market for raw sugarcane. Merely because the price, the distribution, the production, the relationship between the grower and the purchaser, were all subjected to elaborate Government regulations, it could not be said that the product itself lost either its identity or its nature or its character of an agricultural produce sold in the market. The High Court held that Rule 7(2)(a) will clearly apply in this case and market value of sugarcane produced and consumed by the assessee-company had to be computed accordingly.

Under Rule 7(1), in computing the profits and gains of business, market value of an agricultural produce in raw state has to be deducted from the profits of partly agricultural and partly industrial products. Sub-rule (2) lays down the method of computation of market value. If the agricultural produce is ordinarily sold in the market, Rule 7(2)(a) will apply. If not, Rule 7(2)(b) will apply. The question, therefore, is was sugarcane ordinarily sold in the market in raw state? The answer must be in the affirmative. The assessee-company itself was buying more sugarcane, than it was producing, from registered and unregistered ryots.

Mr. Nariman on behalf of the assessee has argued that in order to invoke Rule 7(2)(a) it has to be found that a market exists where sugarcane is ordinarily sold. This implies that there will be a market of a nature where buyers and sellers congregate. If such a market does not exist, the provisions of Rule 7(2)(a) will not apply. Sub-rule (b) was framed by the Board to determine the value of agricultural products where such markets for agricultural products did not exist.

We are unable to uphold this argument. "Market" in the context of Rule 7 does not mean an open market where buyers and sellers get together for the purpose of purchase and sale of goods. The assessee-company regularly, year after year, in ordinary course of business bought sugarcane from registered and unregistered ryots. Whether the purchase was at a price controlled by the Sugarcane Control Order or not is quite immaterial. There was a price at which sugarcane could ordinarily be purchased by the assessee for the purpose of its own business. The price paid by the assessee was the market price. It is by now well-settled that market does not have to be one open place of business where buyer and seller congregate.

If the market is controlled by Government regulation, sale and purchase of sugarcane within the framework of these regulations will be the ordinary mode of selling sugarcane. No special significance can be read into the phrase `ordinarily sold'. It is not disputed that the assessee utilised sugarcane grown by it in its own field for its factory and also purchases a considerable amount of sugarcane from outside. Therefore, it is not the case of assessee that sugarcane growers do not sell sugarcane in ordinary course of their business in the region where the assessee carries on business.

Mr. Nariman next contended that the assessee was buying sugarcane at its own factory gate. There is no other factory in the region where the assessee's factory was situated. The area adjoining the factory gate could not be treated as market for sugarcane. In the fact of this case there was no way to find out the average price of the sugarcane which was being sold in the market in ordinary course during the previous years. In support of this contention, Mr. Nariman relied on a Special Bench decision of the Patna High Court in the case of J.M. Casey vs. Commissioner of Income-tax, Bihar &

Orissa AIR 1930 Patna 44.

This argument again is misconceived. The place where the sugarcane was bought and sold is quite immaterial for deciding whether there was a market for sugarcane or not. The place of delivery of the goods may be decided by the buyer and seller by mutual consent, express or implied. The assessee might have purchased and taken delivery of the goods from the seller's doorstep. The point that has to be borne in mind is that in order to apply Rule 7(2)(a), existence of an open market where buyers and sellers come together to do business is not an essential pre-requisite.

We are unable to uphold the contention of Mr. Nariman that where the buyer was only one and the sellers were many it cannot be said that the sale was in a market and the price was market price. The case of J.M. Casey (supra) was decided by a Special Bench of the Patna High Court in the special and unusual facts of that case. The Special Bench considered the scope and effect of Section 2(1)(b) of the Indian income-tax Act. It was observed that the word "market" in that section implied area centre of economic exchange. The implication of this observation has to be understood in the facts of that case. Motihari Jail purchased aloe leaves from cultivators not for any commercial purpose but to keep the prisoners occupied. The purchase by the jail was not a commercial activity at all. Courtney Terrel, C.J. explained the position thus:

> "The object of the manufacture in jail is not the conducting of an economic process which shall render profitable the cultivation of the aloe plant but merely to keep the prisoners employed on sufficiently laborious and punitive work."

It was held in the facts of the case that purchase of aloe leaves by jails in an artificial condition had no relation to market for agricultural produce. But in the case before us, the purchases of sugarcane made by the factory were purely commercial transactions controlled by market forces within the framework of the Sugarcane Control Order. The Special Bench decision of the Patna High Court does not support the case made out by Mr. Nariman in any way.

The principle that value of a property will be the price which it will fetch if sold in the open market is a well-known method of valuation which has been adopted in a large number of statutes in England and also in India. It is well-settled that existence of an open market is not a pre- condition for application of this principle. There may or may not be an actual market where buyers and sellers congregate to purchase and sell goods. Where there is no such open market an estimate of the market price will have to be done on a hypothetical basis. In a case under the Gift-Tax Act, Gift-Tax Officer, Calcutta & Anr. vs. Kastur Chand Jain 53 ITR 411, dealing with Section 6(1) of that Act, R.S. Bachawat, J. observed:

> "The basic principle of valuation is embodied in section 6(1) of the Gift-Tax Act, 1958, and in the corresponding section, section 36 of the Estate Duty Act, 1953, an section 7(1) of the Wealth-Tax Act, 1957. The valuer has to find "the price which....it would fetch if sold in the open market". The measure of value of the property is the price which the hypothetical buyer in an open market would pay for it."

In the case of Ahmed G.H. Ariff & Ors. v. Commissioner of Wealth-Tax, Calcutta 76 ITR 471, explaining the phrase "if sold in the open market" in Section 7(1) of the Wealth- Tax Act, it was observed by Grover, J. speaking for the Court that the phrase did not contemplate actual sale or the actual state of the market, but only enjoined that it should be assumed that there was an open market and the property could be sold in such a market and, on that basis, the value had to be found out. It was a hypothetical case which was contemplated and the tax officer must assume that there was an open market in which the asset could be sold.

In view of the aforesaid, it is very difficult to uphold the contention of Mr. Nariman that in order to find out the market price there has to be an actual market where there will be `a concourse of buyers and sellers'. This argument was specifically rejected by Lord Pearson L.J. in the case of Building and Civil Engineering Holidays Scheme Management Ltd. vs. Post Office (1966) 1 QB 247 in the following words:

> "What is meant by "market value"? It is not reasonable to suppose that for the purposes of this proviso there is no market value unless there is a concourse of buyers and sellers. There is no need to infer that there must be an open market, or that there must be a price fluctuating according to the pressures of supply and demand."

In that case Lord Denning also explained the concept of market value in the following words:

> "What is the "market value" of these stamps? It does not connote a market where buyers and sellers congregate. The "market value" here means the price at which the goods could be expected to be bought and sold as between willing seller and willing buyer, even though there may be only one seller or one buyer, and even thought one or both may be hypothetical rather than real."

These are the principles universally applied to find out the price at which the goods are ordinarily sold in the open market. For determination of market value, there is no pre-requisite that an open market where buyers ad sellers congregate to buy and sell goods must exist. In the instant case, the assessee-company actually bought sugarcane from a large number of growers years after year in ordinary course of business. The price at which it buys sugarcane must be taken to the market price. If the price is controlled by Sugarcane Control Order the controlled price will be taken as the market price because it is at this price that a willing buyer and a wiling seller are expected to transact business. As Lord Denning pointed out, it does not make any difference to this position that the assessee was the only buyer in the region where its factory was located.

In the facts of this case, we are of the view that the High Court has come to a right decision. The appeals are without any merit and are dismissed. There will be no order as to costs.

C.A. No. 3674/1989, C.A. No. 2399(NT)/1989 AND S.L.P. NO. 2611/ 1988 Mr. Nariman has argued that there are certain facts in these cases which were not brought to the notice of the Tribunal. Therefore, in these cases, there should be a direction by this Court to the Tribunal to investigate those facts.

It is not possible to accede to this prayer. Certain questions of law on the basis of the fact and circumstances found by the Tribunal have been referred to the High Court for its opinion. The High Court has give its opinion on those questions on the basis of facts found by the Tribunal. The Tribunal is the final fact finding authority. The High Court cannot go behind the fats found by the Tribunal. It was for the assessee to raise questions of fact at the time of hearing of the appeal before the Tribunal. At the reference stage, no fresh investigation into facts is permissible. There may be cases where the Court feels that it is unable to answer the question of law referred because findings of fact are incomplete. In such cases, the Court may call for a supplementary statement from the Tribunal. But that is not the case here. The High Court did not feel any difficulty in answering the question on the basis of the facts found. The assessee's prayer is for a direction to the Tribunal to consider new questions of fact which were not raised before the Tribunal at all. We see no reason to grant this prayer at this stage.

These appeals must also fail and are dismissed. The Special Leave Petition No. 2611 of 1988 is also dismissed. There will be no order as to costs.