The Commissioner Of Income Tax vs Shri Shahrooq Ali Khan on 27 August, 2014

Bench: N.Kumar, Rathnakala

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IN THE HIGH COURT OF KARNATAKA AT BANGALORE

DATED THIS THE 27TH DAY OF AUGUST 2014

PRESENT

THE HON'BLE MR.JUSTICE N.KUMAR

AND

THE HON'BLE MRS.JUSTICE RATHNAKALA

INCOME TAX APPEAL NO.784 OF 2008

BETWEEN:

1. THE COMMISSIONER OF INCOME-TAX,
C.R. BUILDING,
QUEENS ROAD,
BANGALORE

2. THE ASST. COMMISSIONER OF
INCOME-TAX (INTL. TAXN.)
CIRCLE-19(1),
C.R. BUILDING,
QUEENS ROAD,
BANGALORE. ...APPELLANTS

(BY SRI K.V.ARAVIND, ADV.)

AND:

SHRI SHAHROOQ ALI KHAN,
REP. BY GPA HOLDER SHRI SAMEER A KHAN,
ASHED PROPERTIES & INVESTMENT,
BARTON CENTRE, 807,
8TH FLOOR, M.G.ROAD,
BANGALORE - 560 001. ...RESPONDENT

(BY SRI S.C.TIWARI, ADV. FOR
SRI L.GOVINDRAJ, ADV.)

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THIS INCOME TAX APPEAL IS FILED UNDER SECTION 260-A OF I.T. ACT, 1961 ARISING OUT OF ORDER DATED 15-02-2008 PASSED IN ITA NO.968/BANG/2005, FOR THE ASSESSMENT YEAR 2000-2001, PRAYING THAT THIS HON'BLE COURT MAY BE PLEASED TO:

I. FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN,

II. ALLOW THE APPEAL AND SET ASIDE THE ORDERS PASSED BY THE INCOME TAX APPELLATE TRIBUNAL, BANGALORE IN ITA NO.968/BANG/2005, DATED 15-02-2008 AND CONFIRM THE ORDER OF THE APPELLATE COMMISSIONER CONFIRMING THE ORDER PASSED BY THE ASSISTANT COMMISSIONER OF INCOME TAX (INTL. TAXN.), CIRCLE-19(1), BANGALORE, IN THE INTEREST OF JUSTICE AND EQUITY.

THIS ITA COMING ON FOR FINAL HEARING THIS DAY, N.KUMAR J., DELIVERED THE FOLLOWING:

JUDGMENT

The Revenue has preferred this appeal against the order passed by the Income Tax Appellate Tribunal, Bangalore (for short hereinafter referred to as 'the Tribunal') upholding the order of the Commissioner of Income-Tax (Appeals), Bangalore, which held that the transaction involving transfer of capital asset in the hands of the assessee yielded in capital gains and not business income in the hands of the assessee.

2. The property known as "Hepburn Hall" situated in Convent Road in the Civil and Military Station of Bangalore, bearing Municipal No.2 belongs to Miss.Rubab Mohamed Ali Kazerani, a resident of Bombay. She entered into a Memorandum of Understanding (for short hereinafter referred to as "MOU") with the assessee to identify buyers for her property. In terms of the MOU, a sum of Rs.5,50,00,000/- was paid by the assessee to the owner of the property. The said MOU is dated 8th June 1995. Contemporaneously with MOU, the owner executed a letter dated 8th June 1995 confirming that she has handed over vacant possession of the said property to the assessee in terms of the MOU. One more letter to that effect was executed on the very same day. Thereafter, the assessee entered into a MOU with the Indian Society of the Church of Jesus Christ of Latter- day Saints and received a sum of Rs.3,73,35,320/- as advance, the total sale consideration being Rs.12,47,84,400/-. In other words, though he paid Rs.5,50,00,000/- to the owner, he earned a sum of Rs.6,97,84,400/- as income from the said property. Subsequently, the owner and the assessee executed a registered sale deed dated 10th May 1999 conveying the aforesaid property in favour of the said purchaser. Thereafter, the assessee declared the income under the head "capital gains" as Rs.3,19,60,831/-. The said return was accepted under Section 143(1) of the Income Tax Act, 1961 (for short hereinafter referred to as 'the Act'). Thereafter, the proceedings were initiated for re-opening of the assessment. The assessee was issued notice. He entered appearance through a

Counsel, filed a detailed reply and requested to drop the proceedings. Thereafter, the Assessing Authority, after carefully considering all the relevant documents produced, was of the view that the transaction in question is in the nature of trade and thus, profits/loss incurred in respect of the transaction would be business income and accordingly, the assessee was taxed.

3. Aggrieved by the said order, the assessee preferred an appeal to the Commissioner of Income Tax (Appeals). The Appellate Authority after referring to various judgments and statutory provisions was of the view that the transaction involved could have been clearly seen as an investment transaction, had the appellant purchased it outright and then resold it. The time gap involved of over three years between purchase and sale and the fact that it is an isolated transaction made with own money and without improving the property turn in assessee's favour. The MOU was not for the purpose of simply identifying the prospective buyer or the consideration received by the seller was only a security deposit. That was a transaction by which the assessee transferred the property in question in the manner prescribed in clauses (v) and (vi) introduced in Section 2(47) of the Act w.e.f. 1.4.1988. Therefore, the finding of the Assessing Officer that the dominant purpose of MOU was to identify buyer and engage in an adventure in the nature of trade is not supported by the legal evidence. The property also cannot be seen as "stock in trade" of the assessee's business. It cannot be excluded from the definition of "capital asset" as given in Section 2(14) of the Act. Therefore, the Appellate Authority held that Section 45(1) of the Act would apply in the facts of the case and not Section 28(1) of the Act and therefore, the income is taxable as capital gains.

4. Aggrieved by the said order, the Revenue preferred an appeal to the Tribunal. Though the Tribunal recorded a categorical finding that Section 53(A) of the Transfer of Property Act is not attracted to the facts of the case, it proceeded to hold that notwithstanding the language and the contents of the MOU, the assessee would have received the rights in the property very much as the owner. Though isolated transaction could also be considered to be resulting in a business transaction, consideration has to be given to similar operations carried out by the assessee in the past or subsequent. The transaction in question appears to be an isolated transaction with no history and no subsequent instances also. The length of holding of the property by the assessee from 8.6.1995 till 1.7.1998 i.e., more than three years, is an indication which supports the claim of the assessee that the intention of the assessee was not to carry on the business as an estate developer or a builder in property. Therefore, the Tribunal held that the assessee must succeed and therefore, the appeal came to be dismissed. Aggrieved by the said order, the Revenue is in present appeal.

5. The substantial question of law framed at the time of admitting the appeal on 2.12.2010 reads as under:

> "Whether the Appellate Authorities were correct in holding that a sum of Rs.6,37,00,726/- received by the assessee for the purpose of finding a purchaser of the property of Mrs.Rubab Mohamed Ali Kazerani, at No.1, Cubbon Road, Bangalore-01, which was sold for Rs.11,87 crores and the owner paid Rs.5.5 crores cannot be brought to tax under the head business income, but should be brought to tax under the head capital gains?"

6. Learned Counsel for the Revenue assailing the impugned orders contends that, a reading of the MOU makes it clear that it is not an agreement to purchase the property. There is no intention on the part of the assessee to purchase this property as an investment. On the contrary, the terms of the MOU categorically state that the assessee offered to identify the buyer for and on behalf of the owner and therefore, the MOU came to be entered into authorizing the assessee to be the sole and exclusive person to identify the buyers for the schedule property or portion thereof. The owner informed the assessee that the total sale consideration acceptable is Rs.5,50,00,000/-, which he received from the assessee. Further terms of the MOU clearly indicate that any amount in excess of Rs.5,50,00,000/- payable by a purchaser would belong to the assessee. In the event of the assessee not being able to receive any higher consideration, any loss so incurred would be to his credit. Therefore, he contends that there was no intention on the part of the assessee to purchase this property. Therefore, Section 53-A of the Transfer of Property Act is not attracted. Even otherwise also, the case would not fall under Section 2(47)(vi) of the Act, as the object of entering into MOU is to identify a purchaser and sell the property to him and make profit

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out of it. The income derived in this transaction is in the nature of business income and accordingly, the Assessing Authority was justified in taxing it as a business income.

7. Per contra, learned Counsel appearing for the assessee contended that, though the MOU is not styled as an agreement of sale, however, it is not registered. It is a document, which falls within the definition of Section 2(47)(vi) of the Act, where any transaction which has the effect of transferring, or enabling the enjoyment of, any immovable property, would constitute transfer. As defined under clause (d) of Section 269UA of the Act, the interest the assessee acquired under the Memorandum of Understanding would constitute an immovable property. Therefore, when the assessee transferred this immovable property to the purchaser, what consideration received in excess of Rs.5,50,00,000/- is the capital gains and therefore, he

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offered it for tax as such and both the Appellate Authorities were justified in holding it as a capital gain and not as business income. Therefore, he submits that no case for interference is made out.

8. The Apex Court in the case of G.Venkataswami Naidu & Co. -vs- Commissioner of Income Tax reported in 35 ITR 594(SC) while dealing with the question whether an income derived from a transaction falls within the heading of "business income" or "capital gains" has held as under:

> "13. As we have already observed it is impossible to evolve any formula which can be applied in determining the character of isolated transactions which come before the courts in tax proceedings. It would besides be inexpedient to make any attempt to evolve such a rule or formula. Generally speaking, it would not be difficult to decide whether a given transaction is an adventure in the nature of trade or not. It is the cases on the border line that cause difficulty. If a person invests money in land

intending to hold it,

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enjoys its income for some time, and then sells it at a profit, it would be a clear case of capital accretion and not profit derived from an adventure in the nature of trade. Cases of realisation of investments consisting of purchase and resale, though profitable, are clearly outside the domain of adventures in the nature of trade. In deciding the character of such transactions several factors are treated as relevant. Was the purchaser, a trader and were the purchase of the commodity and its resale allied to his usual trade or business or incidental to it? Affirmative answers to these questions may furnish relevant date for determining the character of the transaction. What is the nature of the commodity purchased and resold and in what quantity was it purchased and resold? If the commodity purchased is generally the subject-matter of trade, and if it is purchased in very large quantities, it would tend to eliminate the possibility of investment for personal use, possession or enjoyment. Did the purchaser by any act subsequent to the purchase improve the quality of the commodity purchased and thereby made it more readily resaleable? What were the incidents associated with the purchase and resale? Were they similar to the operations

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usually associated with trade or business? Are the transactions of purchase and sale repeated? In regard to the purchase of the commodity and its subsequent possession by the purchaser, does the element of pride of possession come into the picture? A person may purchase a piece of art, hold it for some time and if a profitable offer is received may sell it. During the time that the purchaser had its possession he may be able to claim pride of possession and aesthetic satisfaction; and if such a claim is upheld that would be a factor against the contention that the transaction is in the nature of trade. These and other considerations are set out and discussed in judicial decisions which deal with the character of transactions alleged to be in the nature of trade. In considering these decisions, it would be necessary to remember that they do not purport to lay down any general or universal test. The presence of all the relevant circumstances mentioned in any of them may help the Court to draw a similar inference; but it is not a matter of merely counting the number of facts and circumstances pro and con; what is important to consider is their distinctive character. In each case, it is the total effect of all relevant factors and circumstances that determines the character

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of the transaction; and so, though we may attempt to derive some assistance from decisions bearing on this point, we cannot seek to deduce any rule from them and

mechanically apply it to the facts before us.

14. In this connection, it would be relevant to refer to another test which is sometimes applied in determining the character of the transaction. Was the purchase made with the intention to resell it at a profit? It is often said that a transaction of purchase followed by resale can either be an investment or an adventure in the nature of trade. There is no middle course and no half-way house. This statement may be broadly true; and so some judicial decisions apply the test of the initial intention to resell in distinguishing adventures in the nature of trade from transactions of investment. Even in the application of this test distinction will have to be made between initial intention to resell at a profit which is present but not dominant or sole; in other words, cases do often arise where the purchaser may be willing and may intend to sell the property purchased at profit, but he would also intend and be willing to hold and enjoy it if a really high price is not offered. The intention to

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resell may in such cases be coupled with the intention to hold the property. Cases may, however, arise where the purchase has been made solely and exclusively with the intention to resell at a profit and the purchaser has no intention of holding the property for himself or otherwise enjoying or using it. The presence of such an intention is no doubt a relevant factor and unless it is offset by the presence of other factors it would raise a strong presumption that the transaction is an adventure in the nature of trade. Even so, the presumption is not conclusive; and it is conceivable that, on considering all the facts and circumstances in the case, the court may, despite the said initial intention, be inclined to hold that the transaction was not an adventure in the nature of trade. We thus come back to the same position and that is that the decision about the character of a transaction in the context cannot be based solely on the application of any abstract rule, principle or test and must in every case depend upon all the relevant facts and circumstances".

In the light of the above, our findings in the present case have to be based on the facts and circumstances of

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this case. It is in this context, we have to see the documents entered into between the parties, which are not in dispute. They are the Memorandum of Understanding dated 8th June 1995, 2 letters executed on that day by the owner in favour of the assessee, a Memorandum of Understanding executed by the assessee in favour of the purchaser, Indian Society of the Church of Jesus Christ of Latter-day Saints and lastly the registered sale deed executed by the owner along with the assessee in favour of the said purchaser on 10th May 1999. The nature of transaction, the intention of the parties, the consideration for which the agreements were entered into, and the profit derived from

such transaction had to be gathered from these documents.

9. The first document is memorandum of understanding dated 8.6.1995. In the preamble portion of this document, it is categorically stated that owner is

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desirous of disposing off the schedule property, however she is not residing in Bangalore nor she has any infrastructure for the purpose of identifying buyers. She is also not capable of identifying the purchasers. Therefore, she approached the assessee who has offered to identify buyers for and on behalf of owner. Further clause 4 of the preamble states that the assessee being a builder, having suitable office as well as man power has the necessary infrastructure for the purpose of identifying buyers at Bangalore. Therefore, these clauses make it clear that the owner wanted a person to identify a purchaser and the assessee offered to give that assistance. Thus it is clear that the assessee was neither interested in the property belonging to the owner nor he was interested in purchasing the property. His role was to identify the purchaser for the owner. In this back ground, we have to look into the terms of the MOU. Clause (1) categorically states that owner agrees and appoints the assessee to be sole and exclusive

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person to identify buyers for the schedule property or portion thereof. However, the assessee paid a sum of Rs.5.5 Crores to the owner. The assessee was expecting more than Rs.5.5 Crores from sale of the said property. As at that point of time the Urban Land (Ceiling & Regulation) Act, 1976 was in force and the property was more than Rs.5.5 Crores, the assessee agreed to obtain necessary clearance for the said Act and it was his sole responsibility. At that point of time, for completing of sale transaction, permission of the Income Tax Department under Section 269 Urban Land (Ceiling & Regulation) Act, was also necessary. Therefore, a clause was introduced stating the persons identified by the assessee should obtain the said clearance certificate and the owner in no way responsible for the same and she will only sign the requisite forms. The consideration of Rs.5.5 Crores was a net consideration and the assessee has to bear the cost of stamp duty and legal cost relating to transfer of property. As the second

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party will be incurring expenses for the purposes of developing and identifying buyers of the property belonging to the owner and that he has already paid Rs.5.5 Crores, the consideration the owner was expecting, it was made clear the right that is conferred under the agreement is irrevocable. It was also made clear that after the second party identifies the buyer, he will be entitled to enter into any agreement arrangement to receive the sale consideration. It was agreed that any thing received in excess of the amounts specified in clause (2) i.e., Rs.65,50,00,000/- the said excess amount shall belong to the assessee. It was made clear that the assessee has no right to call upon the owner to return Rs. Rs.5.5 Crores under any circumstances. At the same time, the owner has nothing to do with the profits earned or loss incurred by the second party. It was also clearly

understood that in the event of the assessee getting an amount of sale consideration less

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than Rs.5.5 Crores, the said loss should be to his account and not to the account of the owner.

10. Therefore, from the aforesaid recitals, it is clear that from the day number one the assessee had no intention of purchasing this property, enjoy the property and holding the property for some time before even he could think of selling the property. In other words, it would not be an investment in the property for the purpose of enjoying the property. The intention behind this transaction is to sell the property at a higher price than what the assessee has paid to the owner and make profit out of it. If in the process, any loss has incurred, he cannot complain and he has to bear the loss. Therefore, it is obvious that entire transaction is in the nature of a trade and business where he may make profit or he may incur loss. Two letters written by the owner to the assessee handing over the property is to accomplish the task of completing the sale transaction if

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the assessee is able to identify a buyer so that he could also deliver possession to them.

11. After obtaining the aforesaid document, the assessee identified a buyer namely the Indian Society of the Church of Jesus Christ of Latter-Day-saints. The assessee has entered into a memorandum of understanding dated 19.2.1998 with the said buyer. The total consideration upon the sale of the property is Rs.12,47,84,400/-. Out of the same, the assessee received a sum of Rs.5.5 Crores which he had paid to the owner and Rs.6,97,84,400/- which is described as nomination/assignment fee. On executing the memorandum of understanding a sum of Rs.3,73,35,320/- was paid and 45 days was the period prescribed for completing the sale transaction. After entering into such agreement, a registered sale deed came to be executed on 10.5.1999 both by the owner as well as the assessee in favour of said buyer. In the sale

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deed, it is recited that in the memorandum of understanding dated 8.6.1995 the owner appointed the assessee who was a confirming party to be the sole and exclusive person to identify buyers for the aforesaid property for a total sale transaction of Rs.5,50,000/- and the assessee has since paid the above sum to the vendor. Further it is averred that the assessee has identified the purchaser and an agreement of sale dated 30.6.1998 was entered into and the purchaser got to purchase the property for a consideration of Rs.11,87,00,776/-. The assessee also acknowledged a sum of Rs.3,56,10,217/- as advance payment. Therefore, through out the transaction culminating in the sale of the property in favour of the purchaser, the role of the assessee is that of a person identifying a buyer and for the services rendered by him, he is entitled to receive any amount received by him in excess of Rs.5.5 Crores.

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12. As it is clear from the aforesaid judgment of the Apex Court that if a person invests money in a land intending to hold it, enjoys its income for some time and then sells it at a profit, it is clear case of capital accretion and not a profit derived from an adventure in the nature of trade. The test of initial intention to resell distinguishes the adventures in the nature of trade from the transactions of investment. The presence of such an intention is a relevant factor. Unless it is offset by the presence of other factors, it would raise a strong presumption that the transaction is an adventure in the nature of trade.

13. Yet another factor to be taken note of is whether, the assessee by an act subsequent to entering into memorandum of understanding did anything to improve the quality of the land, or did he enjoy the property at any point of time, or did he make any appreciations? If we look at the transaction, keeping in

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mind the aforesaid factors, it is clear that the initial intention of entering into a memorandum of understanding is to resale the property to a higher price and make profit out of it. He had no intention to enjoy the property or develop the property and the intention to sell is not after such enjoyment. There is no element of pride of possession exhibited by him in the transaction. Therefore, it is a case of an adventure in the nature of trade.

14. It is contended that the case falls under Section 2(47)(vi) of the Income Tax Act, 1961 which reads as under:

> "2(47) "transfer" in relation to a capital asset, includes,
>
> (vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any
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other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property."

15. A careful reading of the aforesaid provision makes it clear that though the memorandum of understanding entered into between the owner and the assessee is not an agreement of sale for transfer of a capital asset and it is not stamped or registered, any transaction which has the effect of transferring or enabling the enjoyment of any immovable property in the nature of a capital asset would fall within the definition of transfer and therefore the consideration they seek for such transfer constitutes capital gains. In the hands of the owner the property, it is a capital asset. Then the amount of Rs.5.5 Crores received under the document by the owner would be liable to tax as capital gains. Now the question before the court is not whether the Rs.5.5 Crores constitutes capital gains or

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not. The question is whether over and above Rs.5.5 Crores paid by the purchaser to the assessee would constitute capital gain. In that context, in the instant case, it is clear that the assessee had no intention to acquire a capital asset in lieu of transfer. His intention was only to identify a buyer for the property to bring about a sale transaction and any amount paid in excess of Rs.5.5 Crores is his profit minus the expenditure which he has incurred. It is clear from the recitals in the memorandum of understanding that even if the assessee is not able to get the purchaser who is willing to pay Rs.5.5 Crores 50,000/- and pays less, the loss is to the account of the assessee. Only in the event of the purchaser is willing to pay more than Rs.5.5 Crores, that profit is his. Therefore, the transaction was entered into with a sole intention of making profits and gains from the aforesaid transaction and as such do not fall within the definition of capital gains. The assessee did not hold the capital asset. He did not transfer the

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capital asset, he only facilitated the transfer of capital asset from the owner to the purchaser. He took the risk. He identified the purchaser. Any amount paid in excess of Rs.5.5 Crores which the owner was expecting from the transaction was his margin of profit.

16. The entire approach of the lower authorities is contrary to the material available on record and not supported by any legal evidence as such it cannot be sustained.

17. Hence, we pass the following:

ORDER

(a) The appeal is allowed.

(b) The substantial question of law is answered in favour of the revenue and against the assessee.

(c) The impugned order is set aside and the order passed by the assessing authority is restored.

(d) Parties to bear their own costs.

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(e) The authority shall give effect to this order after a period of 3 months from the date of receipt of copy of this order.

Sd/-

JUDGE Sd/-

JUDGE KNM/- & RS/*