Court Supreme Court

Title Commissioner Of Income Tax Central, Calcutta & Anr Vs Amalgamated Development, Ltd. **Dated** :21.03.1967

Civil Appeals Nos 169 and 170 of 1966..

Judges RAMASWAMI, V., SHAH, J.C., SIKRI, S.M

JUDGMENT

Ramaswami, J.

These appeals are brought, by certificate, from the judgment of the Calcutta High Court dated December 4, 1962 in Income Tax Reference No. 57 of 1958.

The respondent company purchased the assets and liabilities of the firm, Mugneeram Bangur & Co., (Land Department), hereinafter referred to as the 'firm', on July 7, 1948 for a consideration of Rs. 34,99,300/ . The consideration was paid by the issue of shares to the vendor or its nominees in the share capital of the respondent company. The assets included land at cost, Rs. 12,68,268/ as also goodwill and certain other assets subject to certain liabilities incurred by the firm. By the time the respondent company took over the land, the firm had sold a number of plots in respect of which part of the consideration money had been realised and for the balance Mortgage Bonds had been executed by the purchaser. In respect of those plots there was an undertaking to lay out roads, etc. The respondent company took over the debts as well as the liabilities. After the purchase, the respondent company itself sold certain other plots. The purchaser paid a percentage of the price in cash and undertook to pay the balance with interest at a specified rate in annual instalments which was secured by creating a charge on the land purchased. The sales made by the respondent company were in all material respects similar to the sales made by' the firm. A specimen copy of the sale deeds executed by the firm of the respondent company is Annexure 'A' to the Statement of the Case. The relevant provisions of the sale deed are as follows :

` And whereas the said Vendor hath agreed with the Purchaser to sell him the said land .... hereunder written at the rate of price or sum of Rs. 3,000/ per cotta free from all encumbrances. And Whereas the total amount of price payable in respect of the said plot.... at the rate aforesaid amounts to Rs. 8,708 5 6. And Whereas at the treaty for sale it was agreed by and between the partieshereto that one third or thereabout of the total price will be paid at the time of execution of these presents and the payment of the balance will be secured in the manner hereinafter appearing. Now This Indenture Witnesseth that in pursuance of the said Agreement and in consideration of the sum of Rs, 8,708 5 6 whereof the sum of Rs. 2,908 5 6 of lawful money of India to the said Vendor in hand well and truly paid by the Purchaser at or before the execution of these presents (the receipt whereof the said Vendor doth hereby as well as by receipt hereunder written admit and acknowledge) and the payment of the balance namely the sum of Rs. 5,800/ being secured under a security deed of even date with these presents and executed by the Purchaser in favour of the Vendor creating First Charge upon the said land ....

`. . . And the said Vendor shall at all costs complete the construction of the said twenty five feet wide road on the North of the said plot No. 35A and will also lay out the said surface drains by the side of the said road within a year from the date hereof and will maintain the said road and drains in proper state or repairs and shall arrange for lighting the said roads with electric light till the same are taken over by Tollygunge Municipality

Memo of Consideration

By amount paid as earnest money on 5th August, 1948 Rs.501.0.0

By Cheque (part) No. 6985706 on The Bank of India Ltd., on 30th January, 1949. Rs. 2,407.5.6

By amount secured under Security Deed of even date being these presents and executed by the Purchaser in favour of Vendor. Rs. 5,800.0.0 Rs. 8,708.5.6`

A specimen copy of the mortgage deeds is Annexure 'B' to the Statement of the Case. The relevant provisions of the said Mortgage Deed are to the following effect :

`. . and by the said Indenture of Conveyance it was provided that the payment of the balance of the consideration money, namely, the sum of Rs. 5,800/owing by the said mortgagor to the said mortgagee should be secured by an Indenture of Security Deed of even date being these presents to be executed by the said mortgagor in favour of the said mortgagee immediately after the execution of Conveyance now in recital. Now this Indenture Witnesseth and declares as follows : (1) In consideration of the said premises the said mortgagor doth hereby covenant with the said mortgagee that the said mortgagor will pay to the said mortgagee the said sum of Rs. 5,800/ within ten years to be computed from the date of these presents together with interest thereon at the rate of 8 % per annum calculated from the date of these presents upto the date of payment payable monthly. . . . `

We are concerned in this case with the assessment of the respondent company for two periods. The first period is the accounting year ending June 30, 1949 corresponding to the assessment year 1950 51 and the second period is the accounting year ending June 30, 1950 corresponding to assessment year 1951 52. For the assessment year 1950 51, the respondent company was maintaining its accounts in the mercantile system. According to this system, the value of the land sold was credited at Rs. 373,375/against which the unpaid balance was debited in the debtors' account and shown under the heading `book debts considered good secured against mortgage of land`. Against this sale, there was an item of expenses aggregating to Rs. 2,77,047/ of which the actual expenses paid out in cash was Rs. 1,12,577/ and the estimated expenses against future development was Rs. 1,44,470/ . Out of the actual expenses paid out in cash amounting to Rs. 1,12,577/ , a sum of Rs. 48,238/ was expended for lands sold by the respondent company and a sum of Rs. 64,340/ for expenses incurred by the, respondent company on account of land already sold by the vendor. As already stated, the accounts, were kept in the account books of the respondent company on a mercantile system, for this period. Later on, the respondent company adjusted its accounts on a cash system and submitted a revised return showing a loss of Rs. 11,583/ . The Income tax Officer, in assessing the income for the assessment year 1950 51, originally accepted the cash basis and computed the income. On appeal, the assessment was set aside and the case was remitted to the Income tax Officer for a fresh assessment. In this fresh assessment, the Income tax Officer adopted the mercantile basis on which the books of the respondent company had actually been kept. Thereafter, the Income tax Officer allowed the sum of Rs. 48,238/which was the expenses actually incurred by the respondent company in respect of the lands sold by it but disallowed the sum of Rs. 64,340/ which was the expenditure in respect of the lands which had already been sold by the firm before the respondent company's purchase. With regard to the sale price of the plots, the Income tax Officer held that the entire amount of consideration was to be treated as income, though only a portion of the consideration was realised in cash and the other portion was left outstanding after taking a mortgage on the plots sold from the purchaser as security. With regard to the next assessment year, 1951 52, the respondent company kept its accounts on the cash system and not on mercantile system. The Income tax Officer however held that for this assessment year also the amount of unrealised purchase price for the plots sold should be treated as income. As regards expenses, the Income tax Officer allowed a sum of Rs. 56,953/ being the expenditure in respect of the lands actually

sold by the respondent company but disallowed the amount of Rs. 87,517/ being the expenses incurred in respect of the lands already sold y the firm when the respondent company took over. Against the orders of the Income tax Officer the respondent company preferred appeals to the Appellate Assistant Commissioner who dismissed the appeals by a consolidated order dated November 7, 1956. The respondent company thereafter took the matter in appeal before the Appellate Tribunal. The view taken by the Appellate Tribunal was that the Income tax Officer should have made the assessment on the basis of cash system for the year 1951 52 and for that year only the cash receipts and disbursements should be considered. With regard to the question of unrealised consideration money, the Appellate Tribunal held that for both the assessment years the unrealised consideration should be treated as income. With regard to expenses incurred, the Appellate Tribunal upheld the finding of the Income tax Officer. In other words, for both the assessment years it was held that the expenses incurred in respect of lands already sold before the respondent company took over should be disallowed. At the instance of the respondent company the Appellate Tribunal stated a case to the High Court on the following questions of law :

`1. Whether on the facts and circumstances of the case the entire sums of Rs. 1,12,577/ and Rs. 3,43,155/ for the assessment years 1950 51 and 195152 respectively spent in carrying out the obligations subject to which lands were sold by the assessee were allowable in computing the assessee's profits from the land business.

2. Whether on the facts and circumstances of the case the assessee was liable to be taxed only on the actual realisation of sales in cash subject to the allowances admissible under the Indian Income tax Act ?`

By its judgment dated December 4, 1962 the High Court answered both the questions in favour of the respondent company.

With respect to the first question it was submitted by Mr. Mitra that only the expenditure incurred in the relevant accounting year in connection with the lands sold by the respondent company should have been allowed and not the expenditure incurred in connection with the lands sold by the vendor firm previously. It was not disputed by Mr. Mitra that under the terms of the contract between the vendor firm and the respondent company the latter was bound to meet the obligations of the development of land previously sold by the firm, but the contention was that the lands already sold by the firm were not stock in trade of the respondent company. I as said that expenditure not incurred in connection with stock in trade of the business of the respondent company is not deductible under s. 10(2)(xv) of the Income tax Act. We are unable to accept this argument as correct. It is not, in our opinion, a right approach to examine the question as if all revenue expenditure must be equated with expenditure in connection with the stockin trade. In the present case, the sale deed dated July 7, 1948 shows that the respondent company purchased from the firm a whole running business with all its goodwill and stock in trade and including its liabilities. The respondent company had taken over undeveloped land and the idea was to develop the same by making roads, installing a drainage system, street lighting, etc., and then selling the same in small plots at a profit. The principal inducement therefore for the purchasers was that the respondent company would develop the land and the purchasers would be able to pay by instalments spread over a number of years. At the time the respondent company took over the lands a portion thereof had already been sold by the firm but the development had not been completed and in the sale deeds entered into by the respondentcompany with the subsequent purchasers the respondent company expressly undertook the liability to complete the development within a reasonable time. The argument that the respondent company had nothing to do with the lands already sold which did not form part of its stock in trade is not correct. In the present case, the development of the entire land is an integrated process and cannot be sub divided into water tight compartments as the making of the roads and the provisions for drainage and

street lighting, etc., cannot be related to any particular piece of land but the development has to be made as a whole as a complete and unified scheme. It is a case of commercial expediency and, as pointed out by this Court in Eastern Investments Ltd. v. C.I.T.(1) :

`A sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purposes of the trade.` (approving the dictum of Viscount Cave, L.C. in Atherton v. British Insulated & Helsby Cables Ltd. (10 T.C. 155, 191).

The same test has been applied in Cooke (H.M. Inspector of Taxes v. Quick Shoe Repair Service(2), in which the agreement by which the respondent firm purchased a shoe, repair business provided that the vendor should discharge all liabilities of the business outstanding at the date of sale. The vendor failed to do so, and the respondents, in order to preserve the goodwill and to

(1) 20 1. T. R. 1.
(2) 30 T. C. 460.

in discharge of the vendor's liabilities. It was held by Croom Johnson, J. that the sums so paid by the respondent firm were wholly and exclusively laid out for the purposes of its business and were not capital expenditure and were, therefore, allowable deductions for income tax purposes.

It was also contended by Mr. Mitra that so far as the expenditure incurred in development of plots already sold by the firm is concerned, it was likely that the price paid by the respondent company in the contract of sale dated July 7, 1948 to the firm for taking over the assets and liabilities of the firm had been fixed after taking into account the obligation for the development of such plots. On this assumption it was submitted by Mr. Mitra that the discharge of this obligation must be attributed to the capital struc ture of the respondent company's business and cannot be considered as an obligation incurred in connection with the carrying on of its business. It was argued that such expenditure must be regarded as capital in character and not debatable to the revenue account of relevant accounting years. In support of this proposition Counsel relied upon the decision in Royal Insurance Company v. Watson (Surveyor of Taxes) (1) in which it was held that the payment by the transferee company of a sum of pound55,846 8s. 5d. to the manager in commutation of his annual salary was capital expenditure since the payment formed part of the consideration for the transfer of the business and therefore could not be deducted. On behalf of the respondent company Mr. Asoke Sen 'referred to the decision of this Court in Commissioner of Income Tax (Central), Calcutta v. Mugneeram Bangur & Co. (Land Department) (2) and to the: terms of the sale deed dated July 7, 1 948 and the Schedule thereto and argued that there was no quantification of the obligations taken over by the respondent company under cl. 5 of the sale deed. It was stated by Mr. Asoke Sen that the obligations were not computed and did not form part of the consideration of Rs. 34 lakhs and odd arrived at in the Schedule. In our opinion, there is justification in the argument put forward by Mr. Asoke Sen and the principle of the decision in Royal Insurance Company v. Watson(1) has no application to the present case. There is nothing to show in the present case that the obligation incurred under cl. 5 of the sale deed was quantified and formed part of the consideration amounting to Rs. 34 lakhs and odd mentioned in the sale deed as paid by the respondent company. We accordingly reject the argument put forward by Mr. Mitra on behalf of the appellants on this aspect of the case.

We next proceed to consider the question whether the full price as recited in the sale deed should be regarded as having been rea

lised by the respondent company for the relevant accounting years, mid not merely the actual cash paid by the purchasers. The recital in the sale deed showed the consideration for the transfer of the property, that part of the consideration was paid in cash and the balance was secured by a mortgage executed by the purchasers on the; same date. It was argued by Mr. Mitra that the amounts of the consideration money not received in cash but which were treated as a loan to the purchasers and for which the lands sold were mortgaged in favour of the respondent company, should be treated as constructive receipt of the money by the respondent company and therefore liable to be included in the profits of the respondentcompany derived during the respective accounting years. We are unable to accept this argument as correct. The Memo of Consideration in the sale deed reproduced above shows that there was cash payment of the earnest money on August 5, 1948 (Rs. 501/) and a cheque was paid as part of the consideration on January 30, 1.949 for a sum of Rs. 2,407/5/6 and the balance of the amount `secured under Security Deed of even date`. It is thereforeimpossible to hold in this case that there was any cash payment by the purchasers to the respondent company on the date of the execution of the sale deed and the execution of the mortgage deed on the same date by the purchasers cannot be treated as equivalent to payment of cash. In the circumstances found in the present case it cannot be said that the mere giving of security for the debt by the purchaser was tantamount to payment. We accordingly hold that, in the circumstances of this case, the amount of consideration not received and which the purchasers agreed to pay in future for which lands were mortgaged in favour of the respondent company, cannot be considered to be taxable income for the assessment periods in question. The view that we have expressed is home out by the decision of the Judicial Committee in Commissioner of Income-Tax, Bihar & Orissa v. Maharajadhiraia of Darbhanga(1). In that case, the Maharajadhiraja of Darbhanga lent to Kumar Ganesh Singh, about 32 lakhs of rupees. In the assessment year in question, the Kumar owed to Maharaja six lakhs of rupees as interest. This he did not pay in cash, but entered into an arrangement whereby the assessee took over various items of property in lieu of principal and interest. One of the items so taken over consisted of promissory notes executed by the Kumar in favour of the Maharaja. The question was whether this was income received by the Maharaja. In the course of his judgment,, Lord Macmillan stated at page 161 of the Report as follows:

debtor's own promissory notes, was clearly not the equivalent of cash. A debtor who gives his creditor a promissory note for the sum he owes can in no sense be

(1) 60 I. A. 146.

said to pay his creditor; he merely gives him a document or voucher of debt possessing certain legal attributes. So far then as this item..... is concerned the assessee did not receive payment of any taxable income from his debtor or indeed any payment at all. In so holding their Lordships find themselves in agreement with the learned judges of the High Court who differed on this point from the commissioner.`

For the reasons already expressed, we hold that both the questions referred to the High Court have been rightly answered by it in favour of the assessee and these appeals are without merit and should be dismissed with costs. One set of hearing fee.

Appeals dismissed.