Alapati Venkataramiah

Vs

Commissioner of Income Tax Hyderabad

Civil Appeal No. 5 of 1964

(K. Subha Rao, J. C. Shah, S. M. Sikri JJ)

29.03.1965

JUDGMENT

SIKRI, J. –

This appeal by special leave is directed against the judgment of the High Court of Andhra Pradesh answering the question referred to it under s. 66 of the Income Tax Act, 1922, against the appellant. The question referred to was "whether on the facts and in the circumstances of the case a sum of Rs. 79,494/- is assessable as capital gains in the assessment year 1948-49."

The facts relevant to the question are as follows. The assessment year in question is 1948-49 and the accounting year is the official year 1947-48. The appellant, hereinafter referred to as the assessee, Alapati Venkataramaiah, was the proprietor of Mohan Tile Works, engaged in the manufacture of tiles and bricks and owned the factory buildings, plant and machinery. The assessee entered into an agreement dated March 17, 1948, with one Shri Manthena Venkata Raju agreeing to sell to the Mohan Industries Limited, hereinafter called the Company, the aforesaid factory, plant, machinery, furniture, stocks and goodwill for a sum of Rs. 2,00,000/-. The agreement recited that the assessee had been carrying on business under the name and style of Mohan Tile Works at Tenali and that the company to be called the Mohan Industries Limited is to be formed under the Indian Companies Act, having for its object among other things the acquisition and the working of the said business. It appears that this agreement was drafted before the company was incorporated and the recital clause was not modified when the agreement was actually executed. It is common ground that the Company was incorporated on July 5, 1947, before the date of the agreement. Since the answer to the question turns in part on the construction of the agreement it would be convenient to set out the relevant clauses, which are as follows :

> "1. The vendor shall sell and the company shall purchase :
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> First the Goodwill of the said business (with the exclusive right to represent the company as carrying on such business in continuation of the Vendor or in succession thereto).
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> Secondly all the immovable properties specified in schedule hereto;
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> Thirdly all the plant, machinery, offices furniture, licences, livestocks, carts, implements and utensils to which the vendor is entitled in connection with the said business specified in the Second Schedule hereto;

Fourthly, all materials and semi-processed materials in stock described in the third schedule.

2. The consideration for the said sale shall be the sum of Rs. 2,00,000.00 which shall be paid and satisfied by payment in cash soon after the capital Rs. 3,00,000.00 has been raised or in any other manner agreed upon between the Directors of the Company and Vendor.

6. The purchase shall be completed by Seventeenth day of March, 1948 at Tenali when possession of the premises shall as far as practicable be given to the company and the consideration aforesaid shall be paid and satisfied subject to the provisions of the agreement and thereupon the Vendor and all other necessary parties, if any, shall at the expense of the company execute and do all the assurances and things for vesting the said premises in the company and giving to it the full benefit of this Agreement as shall be reasonably required.

7. If from any cause whatever other than the wilful default of the vendor the purchase shall not be completed by the said 17th day of March, 1948 the company shall pay interest on the said sum of Rs. 2,00,000.00 (Two lakhs) cash at the rate of..... p.c. per annum.

8. Upon the adoption of this agreement by the company in such manners as to render the same binding on the company the said Manthena shall be discharged from all liability in respect thereof.

9. Unless before the day the company shall have become entitled to commence business either of the parties hereto may by notice in writing to the other, determine this agreement and after adopting this agreement the company shall stand in the place of the said vendor for the purpose of this clause.

10. If this agreement shall not be adopted by the company in the manner aforesaid before and day next, either of the parties may by notice in writing to the other determine the same."

The assessee was appointed managing agents of the company on July 15, 1947, and on March 11, 1948, he wrote a letter on behalf of the company to the Director of Industries and Commerce, Madras, furnishing a detailed list of land, building and machinery comprising the assets of the company together with their value, in connection with the grant of loan by Government. On March 20, 1948, the assessee was credited with the price of Rs. 2,00,000/- in the books of the company. On November 22, 1948, sale deed in respect of land was executed in favour of the company. On December 9, 1948, the company mortgaged the land with all its buildings and structures thereon and the machinery, plant and other property for Rs. 1,00,000/- to the State of Madras. On March 16, 1949, the Board of Directors, by resolution No. 22 approved the agreement dated March 17, 1948, and on April 10, 1949, the agreement was approved at the annual general meeting of the company. In the first annual report dated March 22, 1949, it was stated as follows :

"The company was registered on 5th July 1947. The Memorandum of Association and Articles alongwith the prospectus of the company were published and the shareholders and the public are well aware of the objects and the prospectus of this

industry in Andhra. To achieve their objects the directors entered into an agreement called vendor's agreement, with Sri Alapati Venkataramiah, Proprietor of Mohan Tile Works on 17-3-1948."

It appears that the assessee had returned this income as capital gains in his return and the Income Tax Officer, without any discussion, held that the assessee realised an excess of Rs. 79,494/- over and above the original cost and this was capital gains assessable under s. 12B of the Act.

The assessee appealed to the Appellate Assistant Commissioner and in the grounds of appeal stated that "the Income Tax Officer erred in determining the excess over the original cost in respect of the building at Rs. 79,494/- as attracting tax to capital gains. As a matter of fact the building was sold at Rs. 1,69,950, but a sum of one lakh alone was received and the balance is yet to be received. The transaction therefore cannot be said to be completer nor can it be said that the profits had been realised. Therefore, the sum of Rs. 79,494/- as attracting capital gains is absolutely unjustified."

The Appellate Assistant Commissioner observed that the fact that a part of the sale amount had not been realised was irrelevant. Then he said that "at one stage it was contended that there was no legal transfer of the buildings, machinery, etc. to the limited company. There is no substance in this contention also. The limited company is said to have obtained a loan of more than a lakh of rupees from the Madras Government on the basis that they were the owners of the buildings, machinery, etc. which they had purchased from the appellant. The statement therefore that there was no legal transfer cannot be true. I am satisfied that the sum of Rs. 79,494/- as returned by the appellant under the head capital gains was rightly included in the assessment."

The assessee then appealed to the Appellate Tribunal. The Tribunal, by its order dated November 24, 1955, held that "there was in fact no sale, much less legal transfer of lands, buildings, machinery etc., to the limited liability company which was promoted to take over the tiles business. There was only an agreement to sell. In fact, the assessee did not receive a single pie during the year of account or even during the period when the capital gains was in force. He received in all Rs. 1 lakh in several installments beginning from 25-3-1949, which is beyond the year of account. The point that the assessee himself returned the sum of Rs. 79,494/- under the capital gains leads us nowhere. He might have done it under the advice of some "income-tax expert". The assessee cannot be tied down to an inadvisably made wrong statement. In the circumstances, we delete the addition."

It appears that the Commissioner of Income Tax filed an application under s. 35 of the Act for the correction of the Tribunal's order on the ground that the Tribunal had not mentioned in the order certain documents which, if they had been considered, would perhaps support a conclusion different from the one arrived at by the Tribunal. The Tribunal thereupon came to the conclusion that its earlier decision deleting the amount from taxation was based on non-consideration of various materials on record and it proceeded to rectify this order as a mistake apparent from the record. Accordingly it deleted para 4 in its order dated November 24, 1955, and substituted its order dated March 8, 1957. The Tribunal held that in pursuance of cl. 6 of the agreement dated March 17, 1948, the possession of the entire factory was immediately handed over to Mohan Industries and that the sale deed dated November 22, 1948 was executed for consideration of Rs. 4,500/- only and refers only to the land on which the factory is situated, and did not refer to the factory, machinery and plant, etc. which had been taken possession of by Mohan Industries on March 17, 1948. Further it held that the entries in the account books of Mohan Industries under date March 20, 1948, showed that a sum of Rs. 2,00,000/- was credited in favour of the assessee and the asset accounts were debited as follows :

> #Plant & Machinery a/c L.P. 27 Rs. 15,989 0 0Furniture account " 29 18,805 0 0Electric goods " 31 1,289 10 0Site & Construction account " 33 1,26,470 0 0Stock account " 34 30,050 0 0Goodwill account " 40 7,396 6 0 ---------- Total Rs. 2,00,000 0 0##

Further it noticed that the assessee also made corresponding entries in the books on March 20, 1948, by debiting Rs. 2,00,000/- to Mohan Industries and crediting the various accounts in the same way. The Tribunal also relied on the letter dated March 11, 1948, from Mohan Industries to the Director of Industries, and the first annual report dated March 22, 1949. As stated above, the Tribunal referred the question set out above.

The High Court came to the conclusion (1) that in the circumstances of the case it is immaterial as to when the money was actually paid because the transfer had already been made by putting the company in possession; (2) that the words used in s. 12B are sale, exchange, relinquishment or transfer. If transfer is equivalent to sale, in that it should only be by a registered instrument, the Legislature would not have used two different words for that purpose. All that is required for the purpose of this section is that the assessee should have a right to receive the profits and not that the he should have in fact received it. The assessee, in their view, had a right to receive the two lakh of rupees under the agreement immediately and in fact he treated it as having been received; (3) the entire movable and immovable property was transferred by giving possession to the company in the year of account and in order to perfect the title the only thing that is required was a registered conveyance in respect of land which was done subsequently; and (4) that it is apparent from the entire transaction and the method of accounting adopted both by the assessee and the company that the income had arisen to the assessee in the year of account and there is no justification even for the contention that atleast immovable assets should be deemed to have been transferred only in the year in which the actual sale deed was executed. Accordingly, it answered the question in the affirmative.

Mr. A. V. Vishwanatha Sastri, the learned counsel for the assessee contends that under s. 12B of the Income Tax Act, as it stood at the relevant time, profits and gains are deemed to be the income of the previous year in which the sale, exchange or transfer took place. He says that the sale took place when on March 16, 1949, the Board of Directors ratified the agreement dated March 17, 1948; till then there was only an agreement to sell and that an agreement to sell is neither a sale nor a transfer of a capital asset. The relevant part of s. 12B was in the following terms :

> "12B. Capital gains - (1) The tax shall be payable by an assessee under the head "Capital gains" in respect of any profits or gains arising from the sale, exchange or transfer of a capital asset effected after the 31st day of March 1946 and before the 1st day of April 1948; and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange or transfer took place....."

The word "capital asset" was defined to mean "property of any kind held by the assessee whether or not connected with his business, profession or vocation but does not include (i) any stock-in-trade, consumable stores or raw materials held for the purpose of his business, profession or vocation."

The question which arises is whether any sale or transfer took place before the first day of April, 1948. Up to that date, apart from the agreement to sell, three events had taken place. First, the assessee as managing agents had written on March 11, 1948, i.e., before the agreement was signed, to the Government regarding loan. Secondly, on March 17, 1948, the possession of the land and the buildings and machinery had been given to the company. Thirdly, on March 20, 1948, the assessee

had been credited with the price of Rs. 2,00,000/- in the books of the company and he had also made appropriate entires in his own account books.

Turning now to the agreement dated March 17, 1948, it is urged that this is an agreement to sell and not a sale deed. This is evident from clause 1 of the agreement. Further it is contended that it is a conditional agreement to sell. Reliance is placed on clauses 8 and 9 of the agreement. Clause 8 expressly contemplates adoption of the agreement by the company in such manner as to render the same binding on the company, and clause 9 contemplates that it is only after the adoption of the agreement that the company shall stand in the place of the said Mantana Venkata Raju. It seems to us that it was a conditional agreement to sell and before it could ripen into a contract between the company and the assessee, it had to be adopted by the company. We may mention that Mr. Rajagopala Sastri urged that we should discard clauses 8 and 9 because they were meant to operate if the agreement had been executed before the incorporation of the company. But we are unable to rewrite the agreement. Clauses 8 and 9 are appropriate in an agreement which is made by an agent subject to confirmation by a principal and must be given effect to.

When was the agreement adopted by the company ? We are relieved from addressing ourselves to this question because in the statement of the case, which was agreed to by the assessee and the Revenue, it is stated that "the said agreement was approved and accepted by a resolution of the Board of Directors of the Company on 16.3.1949 and in and by the said resolution the company agreed to pay purchase price in instalments commencing from 31.3.1949. The agreement was subsequently approved by the general body of share holders at a meeting held on 10-4-1949 and on such approval, acceptance and adoption, the agreement became binding on the assessee and the company."

Even if the agreement was accepted by the company in 1949, the question still remains whether any sale or transfer of assets took place before April 1948. Sale or transfer of an asset could take place, as it did in respect of the site, even before the agreement was accepted. The assets comprised of two items of immovable property, viz., Plant and machinery valued at Rs. 15,989/- and site and buildings valued at Rs. 1,26,470/-. It is clear that title to these assets could not pass to the company till the conveyance was executed and registered. (See Commissioner of Income Tax v. Bhurangva Coal Co. [34 I.T.R. 802]. No such conveyance was executed before April 1, 1948. It is only on November 22, 1948, that a sale deed was executed and registered in respect of the site. Therefore, it is clear that the title to these assets did not pass to the company till after April 1, 1948, and consequently no sale took place of these assets before April 1, 1948.

Mr. Rajagopala Sastri however urges in the alternative that even if no sale took place before April 1, 1948, the assets had been transferred to the company before that date. He says that 'transfer' is a wide word and had been used in s. 12B to cover those cases where rights in assets have been transferred in such a manner as to give rise to capital gains. He further urges that in this case possession of the assets was transferred to the company on March 17, 1948, and the assessee could never get back possession of the immovable assets in view of s. 53A of the Transfer of Property Act. In none of the cases cited before us has this point been considered. We are unable to sustain this contention. Before s. 12B can be attracted, title must pass to the company by any of the modes mentioned in s. 12B, i.e. sale, exchange or transfer. It is true that the word 'transfer' is used in addition to the word 'sale' but even so, in the context transfer must mean effective conveyance of the capital asset to the transferee. Delivery of possession of immovable property cannot by itself be treated as equivalent to conveyance of the immovable property.

The High Court has relied on the entries made in the account books of the assessee and the company on March 20, 1948, but the date of sale or transfer according to s. 12B is the date when the sale or transfer takes place, and it seems to us that the entries in the account books are irrelevant for the purpose of determining such a date.

Mr. Rajagopala Sastri contends that the assessee should not be allowed at this stage to draw a distinction between movable and immovable assets, but in the statement of the case, which was agreed to by the assessee and the Revenue, a distinction is drawn thus :

> "The building and site was valued at Rs. 1,26,470/-. The machinery and electrical fitting which were permanently embedded in the earth were respectively valued at Rs. 15,989/- and Rs. 1,298-10-0. The stocks were valued at Rs. 30,050/- and goodwill at Rs. 7396-6-0."

We are, therefore, unable to prevent the assessee from relying upon the distinction between movable and immovable assets. In the result, we hold that the following assets were not sold or transferred before April 1, 1948.

> (i) Machinery valued at Rs. 15,989-0-0.
>
> (ii) Electrical fittings valued at Rs. 1,289-10-0.
>
> (iii) Buildings and site valued at Rs. 1,26,470-0-0.

Therefore, no capital gains in respect of these items arose in the previous year ending March 31, 1948.

This brings us to the movable assets. Stocks valued at Rs. 30,050/- are expressly exempt from the definition of capital asset, and therefore we hold that no capital gain accrued in respect of their sale or transfer. This leaves furniture valued at Rs. 18,805/-, and goodwill valued at Rs. 7,396/6/-. There is no doubt that possession of furniture was delivered on March 17, 1948, and as title to furniture can pass by delivery, capital gains, if any, accrued on that date. In the circumstances of the case, delivery must have been made with the intention of passing title. The position regarding goodwill is however different. It is an intangible asset and it ordinarily passes alongwith the transference of the whole business. It cannot be said in the circumstances of this case that the goodwill was transferred before April 1, 1948. Accordingly, we hold that only one asset, namely, furniture was transferred before April 1, 1948. In the result, we answer the question referred to the High Court as follows :

> "In the facts and circumstances of the case the sum of Rs. 79,494/- is not assessable as capital gains in the assessment year 1948-49, but only such part of it, if any, as is attributable to the capital gain made by the transfer of furniture valued at Rs. 18,805/- is assessable."

The appeal is accordingly accepted and as the assessee has succeeded substantially he will have his costs here and in the High Court.

Appeal allowed.

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