M/s. Killick Nixon & Company

Vs

Commissioner of Income-Tax, Bombay

Civil Appeal No. 1919-1920 of 1966

(J. C. Shah, S. M. Sikri, V. Ramaswami JJ)

05.05.1967

JUDGMENT

SHAH, J. –

These are cross appeals from the order passed by the High Court of Bombay recording answers to questions submitted in a reference under s. 66 of the Indian Income-tax Act, 1922.

Messrs Killick Nixon & Co. - hereinafter called "the assessee" - was a firm which carried on diverse trading activities in Bombay. The assessee agreed to sell on November 28, 1947 to a Company called "Killick Industries Ltd. ", the benefit of managing agency contracts held by it, shares of limited Company (including 240 shares of the Cement Agencies Ltd.) and debentures, and book and other debts in consideration of 79,993 shares of the face value of Rs. 100/-each of Killick Industries Ltd. and Rs. 700/-in cash. By another agreement dated January 29, 1948 the assessee agreed to sell to "Killick Nixon & Co. Ltd. " goodwill of the business of the assessee freehold and leasehold hereditaments, plant and machinery, stock in trade and book debts, Government securities and shares and full benefit of all shipping and general agencies, distributorships etc. in consideration of 9,996 shares in the Vendee Company of the face value of Rs. 100/-each and Rs. 400/-in cash. The assessee was dissolved and its business was discontinued with effect from February 1, 1948.

In a proceeding for assessment to tax payable by the assessee for the year 1949-50 (the relevant previous year being the year ending June 30, 1948) the Income-tax Officer assessed the capital gains made by the assessee, on the transfer of its capital assets to the two Companies, at Rs. 32,01,747/-. In appeal, the Appellate Assistant Commissioner modified the order. He was of the view that the assessee had made capital gains amounting to Rs. 25,40,737/-by sale of shares to the two companies and other assets transferred to Killick Nixon & Co. Ltd. and had suffered a capital loss of Rs. 4,00,530/-, being the difference between the market value of the managing agencies, 240 shares of the Cement Agencies Ltd. and the goodwill on January 1, 1939 estimated at Rs. 51,40,802/-and the market value of those assets on February 1, 1948 estimated at Rs. 47,40,272/-. Debiting the loss against the capital gains made by sale of shares the Appellate Assistant Commissioner brought to tax an amount to Rs. 21,06,455/-. The Appellate Assistant Commissioner rejected the claim of the assessee to the benefit of s. 25(3) & (4) of the Income-tax Act, 1922. The Appellate Tribunal confirmed the order passed by the Appellate Assistant Commissioner.

The Tribunal drew up a statement of the case and referred two questions numbered (1) & (2) below to the High Court of Judicature at Bombay. Two more questions numbered (3) & (4) were submitted pursuant to the order made by the High Court under s. 66(2) of the Act. The question were :

> " (1) Whether on the facts and circumstances of the case, the assessee firm is entitled to the benefit contained under s. 25(3) in respect of capital gains assessed to tax under s. 12B of the Income-tax Act ?
>
> (2) Whether on the facts and in the circumstances of the case, the assessee firm is liable to pay capital gains in respect of profits and gains arising from the sale of its assets to the limited companies ?
>
> (3) Whether s. 12B of the Indian Income-tax Act. 1922, at all applied to the applicant's case ?
>
> (4) Whether on the facts and in the circumstances of the case, the Tribunal misdirected itself in law and or acted without evidence or in disregard of the most material evidence on record in making the valuation of the applicant's assets on first day of January one thousand nine hundred and thirtynine ?"

The High Court answered the first question in the negative, and the second, the third and the fourth questions in the affirmative. The assessee has appealed against the answers recorded on the first three questions; against the order recording the answer on the fourth question, the Commissioner has appealed.

The appeal filed by the Commissioner may first be considered. The assessee contended before the Tribunal, relying upon the evidence on record, that the value of the managing agencies, 240 shares of the Cement Agencies Ltd. and the goodwill on January 1, 1939 considerably exceeded Rs. 51,40,802/-. The Tribunal observed in paragraph-10 of its judgment :

> "We do not think it is necessary to deal with in detail the evidence produced before the Income-tax authorities in respect of the valuation as on 1-1-1939. The stand taken by the assessee, in our opinion, in inconsistent. A uniform method must be adopted both as on the date of the transfer and as on 1-1-1939. It is not open to the assessee to value an asset by applying one method on 1-2-1948 and another on 1-1-1939."

The Tribunal then observed that since the assets were transferred to a company which the partners of the assessee were interested and the transfer was made for a consideration which was less than the market value, it was not open to the assessee to contend that the market value of the assets on January 1, 1939 should be taken into account; that the assessee was not entitled to reduce the capital gain by adopting the valuation of those assets which had a market quotation and in respect of assets which had no market quotation by adopting the sale price; and that "if the goodwill of the business on January 1, 1939 was worth Rs. 8 lakhs its value on February 1, 1948 should be higher." The Tribunal recorded its conclusion that :

> "For the purpose of this appeal, it is enough to say that if the value of the assets in question was Rs. 46, 40,279/-on 1-2-1948, it could not be higher than Rs. 51,40,802/- as on 1-1-1939. Speaking for ourselves, we think, the Income-tax authorities by allowing the loss of Rs. 4 lakhs have taken a liberal view of the whole question."

The Tribunal also observed :

> "The valuation placed by the Department, in our opinion is reasonable. Even if the business was to be valued as a whole, it could not affect the assessment made. The

valuation has to be done on the same basis both on 1-1-1939 and 1-2-1948."

The High Court in dealing with the questions referred observed that under the third proviso to s. 12B(2), of the Income-tax Act, 1922 the assessee was entitled to substitute the fair market value of the assets as on January 1, 1939 if the capital assets had been held by the assessee before January 1, 1939 in place of the cost of the assets for the purpose of determining the capital gain, and that it was common ground that the full value of the consideration for which the assets were transferred was Rs. 1,16,75,108/-. The High Court then observed :

"It is clear beyond any doubt that the assessee was entitled to take the fair market value of the three assets viz., the managing agencies, 240 shares of the Cement Agencies Limited and the goodwill of its business as on 1-1-1939 for the purpose of the computation of the capital gains and, if any, had to be determined by deducting the said valuation as on 1-1-1939 from the full value of the consideration, which the assessee had received and which, it was common ground between the parties, was Rs. 1,16,75,108/-. The Appellate Assistant Commissioner had proceeded to determine the value of its assets as on 1-1-1939. As against the said valuation arrived at by the Appellate Assistant Commissioner, the assessee has raised objections before the Tribunal which objections the Tribunal had to consider on their merits. In so far as the Tribunal has failed to do so and has proceeded on the erroneous view, which it has taken that it was not necessary to deal in detail with the evidence produced before the Income-tax authorities, the Tribunal has clearly misdirected itself and had also not applied its mind properly to the materials on record."

Section 12B which was introduced in the Indian Income-tax Act, 1922 with effect from the 31st day of March, 1974, omitting parts not material reads as follows :

" (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 March, 1946; and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange or transfer took place :

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(2) The amount of a capital gain shall be computed after making the following deductions from the full value of the consideration for which the sale, exchange or transfer of the capital asset is made, namely;

(i) expenditure incurred solely in connection with such sale, exchange or transfer;

(ii) the actual cost to the assessee of the capital asset, including any expenditure of a capital nature incurred and borne by him in making any additions or alterations thereto, but excluding any expenditure in respect of which any allowance is admissible under any provision of section 8, 9, 10 and 12.

Provided that where a person who acquires a capital asset from the assessee, whether by sale, exchange or transfer, is a person with whom the assessee is directly or indirectly connected, and the Income-tax Officer has reason to believe that the sale, exchange or transfer was effected with the object of avoidance or reduction of the liability of the assessee under this section, the full value of the consideration for

which the prior approval of the Inspecting Assistant Commissioner of Income-tax, be taken to be the fair market value of the capital asset on the date on which the sale, exchange or transfer took place :

Provided further...........

Provided further that where the capital asset became the property of the assessee before the 1st day of January 1939 he may, on proof of the fair market value thereof on the said date to the satisfaction of the Income-tax Officer, substitute for the actual cost such fair market value which shall be deemed to be the actual cost to him of the asset, and which shall be reduced by the amount of depreciation, if any, allowed to the assessee after the said date and increased or diminished, as the case may be by any adjustment made under clause (vii) of sub-section (2) of section 10;"

Computation of the capital gains under s. 12B is to be made by deducting from the market value of the consideration of the sale, exchange or transfer, expenditure incurred in connection with such sale, exchange, or transfer and the actual cost to the assessee of the capital asset or at his option where the capital assert became the property of the assessee before January 1, 1939, the fair market value of the asset on January 1, 1939. It is open to the Income-tax Officer, if it appears to him, that with the object of avoiding or reducing of the liability of the assessee to pay tax, the full value of the consideration for which the sale, exchange or transfer is made is understated and the person acquiring the capital asset is a person with whom the assessee is directly or indirectly connected to determine the fair market value of the capital asset on the date on which the sale, exchange or transfer took place.

The difference between proviso one and proviso three may be noticed. By virtue of the first proviso the Income-tax Officer is, in the conditions set out therein, entitled to determine the fair market value of the asset at the date of the sale, exchange or transfer. Under the third proviso, the assessee when he has exercised the option to adopt the value on January 1, 1939 is, for computation of the actual cost to him of an asset transferred required to prove the fair market value of the asset on January 1, 1939, when the asset transferred belonged to him before that date.

There was no dispute in the present case about the market value at the date of the transfer of the assets conveyed. The first proviso therefore did not come into play. The dispute related to the value to the assessee on January 1, 1939 of three assets, viz., the managing agencies, 240 shares of the Cement Agencies Ltd. and the goodwill. The capital gain or loss had to be determined by deducting from the market value of the asset on February 1, 1948 the fair market value of those assets on January 1, 1939 proved by the assessee to the satisfaction of the Income- tax Officer.

The Appellate Assistant Commissioner estimated the value of the three assets on January 1, 1939 at Rs. 51,40,802/-. The assessee contended that the evidence on the record showed that the market value exceeded the estimated value. It is true that the onus by upon the assessee to prove the fair market value of the assets on January 1, 1939 to the satisfaction of the Income-tax Officer and therefore of the Tribunal. The Tribunal did not consider the evidence and disposal of the claim of the assessee after observing that the value of the assets could not exceed the amount at which it was estimated by the Appellate Assistant Commissioner.

Under the scheme of the Income-tax Act, the Tribunal is the final authority on questions of fact. The Tribunal in deciding an appeal is bound to consider all the evidence, and the arguments raised

before it by the parties. The Tribunal apparently did not consider the evidence : it merely recorded a bare conclusion without setting out any reasons in support thereof. It is therefore not possible to say whether the Tribunal considered the evidence and the contentions raised by the assessee : it cannot be assumed merely because a conclusion is recorded that the Tribunal considered the evidence. The High Court was, therefore, right in recording an answer in the affirmative on the fourth question. It will be the duty of the Tribunal in disposing of the appeal under s. 66(5) of the Income-tax Act to hear the parties and to determine on a consideration of the evidence the value of the three assets on January 1, 1939 in the light of the third proviso to s. 12B(2).

In the appeal filed by the assessee, counsel for the assessee has not challenged the finding recorded on questions Nos. (2) & (3) and nothing more need be said in respect of those questions. Counsel claimed that by virtue of s. 25(3) of the Indian Income-tax Act, the assessee is exempted from paying tax in the year in which the business was closed. Reliance is placed upon s. 25(3) of the Indian Income-tax Act. It provides, insofar as it is material :

> "Where any business, profession or vocation on which tax was at any time charged under the provisions of the Indian Income-tax Act, 1918, (VII of 1918), is discontinued, then, unless there has been a succession by virtue of which the provisions of sub-section (4) have been rendered applicable, no tax shall be payable in respect of the income, profits and gains of the period between the end of the previous year and the date of such discontinuance......"

It is common ground that the assessee was assessed to tax in respect of the income from business under the Indian Income-tax Act 7 of 1918 and the case is not one of succession by virtue of which the provisions of sub-s. (4) of s. 25 are rendered applicable. Prima facie, the assessee was entitled to the benefit of s. 25(3) i.e. it was exempted from payment of tax in respect of the income, profits and gains earned by carrying on business for the period between the end of the previous year and the date of discontinuance of the business. This Court observed in Commissioner of Income-tax, Bombay City I v. Chugandas and Co. that the exemption under s. 25(3) is not restricted only to income on which tax was payable under the head "Profits and gains of business, profession or vocation" under the Act of 1918. Counsel for the assessee contended that even though under the Act of 1918 capital gain was not charged to tax under the Income-tax Act, 1922, as amended in 1947, since capital gains earned by the assessee form part of the income of the assessee as defined in s. 2(6C) of the Act, and are on that account eligible to tax as income of the business, the assessee is entitled to the benefit of exemption prescribed by s. 25(3) of the Act.

Counsel for the Commissioner contended that on income earned from business which is discontinued, the assessee is entitled to exemption from payment of tax for the period during which the business was carried on in the year in which the business was discontinued. He conceded that income which qualifies for exemption is income earned by carrying on business and not merely income computed for purposes of tax under s. 10 of the Act, but he contended that the exemption does not apply to receipts which are not earned by carrying on the business, and are only fictionally deemed income for the purpose of the Income-tax Act. He said that in any event capital gains cannot be said to be income resulting from the activity styled "business", and on s. 25(3) of the Act.

Chugandas & Company's case has, in our judgment, no application to the present case. In that case the assessee firm was charged to tax on its income from business under the Indian Income-tax Act, 1918. The assessee firm discontinued its business on June 30, 1947, and in respect of interest on securities which formed part of the assessee's business income, exemption was claimed under s.

25(3). This Court accepted the contention of the assessee. It was observed at p. 338 :

> "When, therefore, section 25(3) enacts that tax was charged at any time on any business, it is intended that the tax was at any time charged on the owner or any business. If that condition be fulfilled in respect of the income of the business under the Act of 1918, the owner or his successor-in-interest qua the business, will be entitled to get the benefit of the exemption under it if the business is discontinued. The section in terms refers to tax charged on any business, i.e. tax charged on any person in respect of income earned by carrying on business. Undoubtedly, it is not all income earned by a person who conducted any business, which is exempt under sub-section (3) of section 25 : non- business income will certainly not qualify for the privileges."

It is not necessary for the purpose of these appeals to decide whether an assessee is entitled to exemption under s. 25(3) in respect of a receipt which was not chargeable as income under the Act of 1918, for, in our view, capital gains though they are income within the meaning of s. 2(6C) as incorporated by Act 7 of 1939, and modified by Act XXII of 1947, are not income earned from trading activity carried on by an assessee, and therefore cannot be admitted to exemption under s. 25(3).

In Commissioner of Income-tax, Madras v. Express News papers Ltd this Court expounded the true nature of capital gains at p. 202:

> "Under that section (s. 12B) the tax shall be payable by the assessee under the head 'capital gains' in respect of any profits or gains arising from the sale of a capital asset effected during the prescribed period. It says further that such profits or gains shall be deemed to be income of the previous year in which the sale etc., took place. This deeming clause does not lift the capital gains from the sixth head in section 6 and place it under the fourth head. It only introduces a limited fiction, namely, that capital gains "accrued will be deemed to be income of the previous year in which the sale was effected. This fiction does not make them the profits or gains of the business."

Capital gains by the definition under s. 2(6C) are income, and they are liable to tax by virtue of s. 6 read with s. 12B; and if they are not income arising from a trading activity, the benefit of exemption from taxability arising from the discontinuance of the business will not, in our judgment, be available in respect of that head of income. It is only income which is earned by carrying on business which is entitled to exemption under s. 25(3) and capital gains not being income which arise from trading activity, they are not entitled to exemption.

Both the appeals therefore fail and are dismissed with costs.

V. P. S.

Appeals dismissed

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