

P.M. Mohammed Meerakhan

Vs

Commissioner of Income-Tax, Kerala

Civil Appeal No. 1230 of 1967

(J.C. Shah, V. Ramaswami - I, A.N. Grover JJ)

12.02.1969

JUDGMENT

RAMASWAMI J. -

In this case the appellant (hereinafter called the assessee) was assessed for the assessment year 1956-57 on a total income of Rs. 8,400. The Income-tax Officer later on came to know that the assessee's income from the sale of estates had escaped assessment. The Income-tax Officer took action under section 34(1) (a) of the Income-tax Act, 1922, (hereinafter called the Act), for the assessment year 1956-57 on 13th August, 1959.

Under an agreement dated 18th May, 1955, a company called Mundakayam Valley Rubber Co. Ltd. sold and delivered an estate called Kuttikal Estate to one Mr. A. V. George. The area of the estate was 477 acres and 71 cents. Mr. A. V. George had entered into the agreement in his own name and on behalf of another company called the Kailas Rubber Co. Ltd. It was agreed that the vendor would execute the necessary conveyance in favour of Mr. A. V. George or his nominees. On 15th August, 1955, the assessee entered into an agreement with Mr. A. V. George whereby the assessee agreed to purchase 447.71 acres forming part of Kuttikal Estate for Rs. 6 lakhs. An advance of Rs. 11,000 was paid by the assessee. The balance of Rs. 5,89,000 was to be paid by the assessee on or before 25th September, 1955. It was agreed that Mr. A. V. George should execute a sale deed himself or cause it to be executed by Kailas Rubber Co. Ltd. on whose behalf he was acting in favour of the assessee or his nominees. The assessee subsequently div

Rs. "Sale price of 373 acres 5,18,500 Value of 104 acres retained by the assessee at Rs. 2,000 per acre 2,08,000 ----- 7,26,500 Less cost 6,00,000 ----- 1,26,500" -----##

The Income-tax Office held that a sum of Rs. 1,25,000 in round figures represented the assessee's profit from an adventure in the nature of trade and included this amount in his total income under section 34(1) (a) of the Act. The assessee appealed to the Appellate Assistant Commissioner who rejected the appeal. The assessee took the matter in further appeal to the Appellate Tribunal which also rejected the appeal holding that the amount of Rs. 1,25,000 represented profit from an adventure in the nature of trade. At the instance of the assessee the Appellate Tribunal stated a case to the High Court on the following question of law :

"Whether, on the facts and in the circumstances of the case, the transactions constituted a venture in the nature of trade and the surplus of Rs. 1,25,000 was assessable to tax ?"

By its judgment dated 10th October, 1966, the High Court of Kerala answered the question in the affirmative and against the assessee. This appeal is brought by special leave from the judgment of the High Court of Kerala dated 10th October, 1966, in Income-tax Reference No. 18 of 1965.

The question whether a transaction is an adventure in the nature of trade must be decided on a consideration of all the relevant facts and circumstances which are proved in the particular case. The answer to the question does not depend upon the application of any abstract rule or principle or formula but must depend upon the total impression and effect of all the relevant facts and circumstances established in the particular case. In *Californian Copper Syndicate v. Harris*, Lord Justice Clerk observed :

"It is quite a well settled principle in with questions of assessment of income tax that where the owner of an ordinary investment chooses to realise it, and obtains greater price for it than he originally acquired it at, the enhanced price is not profit... assessable to income tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business...

What is the like which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being - is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making ?"

But in judging the character of such transactions several factors have been treated as significant in decided cases. For instance, if a transaction related to the business which is normally carried on by the assessee, though not directly part of it, an intention to launch upon an adventure in the nature of trade may readily be inferred. A similar inference would arise where a commodity is purchased and sub- divided, altered, treated or repaired and sold or is converted into a different commodity and then sold. The magnitude of the transaction of purchase, the nature of the commodity the subsequent dealings of the assessee, the nature of the organisation employed by the assessee and the manner of disposal may be such that the transaction may be stamped with the character of a trading nature. In *Martin v. Lowry*, the assessee purchased a large quantity of aeroplane linen and sold it in different lots, and for the purpose of selling it started an advertising campaign, rented offices, engaged an advertising manger

"It is general more easy to hold that a single transaction entered into by an individual in the line of his own trade (although not part and parcel of his ordinary business) is an adventure in the nature of trade than to hold that a transaction entered into by an individual outside the line of his own trade or occupation is an adventure in the nature of trade. But what is a good deal more important is the nature of the transaction with reference to the commodity dealt in. The individual who enters into a purchase of an article or commodity may have in view the resale of it at a profit, and yet it may be that that is not the only purpose to which he purchased the article or the commodity, nor the only purpose to which he might turn it if favorable opportunity of sale does not occur. In some of the cases the purchase of a picture has been given as an illustration. An amateur may purchase a picture with a view to its resale at a profit, and yet he may recognise at the time or afterwards that the possession of t

These are cases of commercial commodities but a transaction of purchase of land cannot be assumed without more to be an adventure in the nature of trade. In *Leeming v. Jones*, a syndicate was formed to acquire an option over a rubber estate with a view to re-sell it at a profit, and finding the estate too small the syndicate acquired another estate and sold the two estates on profit. It was held that the transaction was not in the nature of trade and the profit was not liable to be assessed to tax. The same view was expressed in *Saroj Kumar Mazumdar v. Commissioner of Income-tax*, in which the assessee who carried on business of engineering works purchased land, which was under requisition by the Government, negotiated a sale before the land was de-requisition and sold it after the land was released. But the circumstances of a particular case may lead to the conclusion that the purchase or re-sale of land is in the nature of trade. In *G. Venkataswami Naidu & Co. v. Commissioner of Income-tax*, the appellant fir

As we have already said it is not possible to evolve any single legal test or formula which can be applied in determining whether a transaction is an adventure in the nature of trade or not. The answer to the question must necessarily depend in each case on the total impression and effect of all the relevant factors and circumstance proved therein and which determine the character of the transaction. What then are the material facts found in the present case ?

It is clear from the recital of the agreement dated 15th October, 1955, that the intention of the assessee in purchasing the estate was to re-sell it at a profit. An advance of Rs. 11,000 was paid by the assessee on that date, the balance of Rs. 5,89,000 was to be paid on or before 25th September, 1955. It was one of the terms of the agreement that Mr. A. V. George was to execute the sale deed either in favour of the assessee or his nominees. It was also found that the assessee did not have the resources to buy any estate worth a lakh of rupees when he entered into the agreement for the purchase of Kuttikal Estate for an amount of Rs. 6 lakhs. In the intervening period between 15th August, 1955, and 31st March, 1956, the assessee divided the estate into 23 plots and arranged for the sale of 22 plots to different purchasers. The division of the land into 23 plots and the sale to the various purchasers indicate that there was scheming and organisation on the part of the assessee. It was found that the assessee was right in its conclusion that the transactions of the assessee constituted an adventure in the nature of trade and were in the course of a profit-making scheme and the question was rightly answered by the High Court against the assessee.

It was then contended on behalf of the appellant that, even assuming that there was an adventure in the nature of trade, the profits from such an adventure have not been properly ascertained in the present case. It was said that the income-tax authorities were wrong in holding that the value of the 23rd plot retained by the assessee represented the profit made in the transaction. The argument was that the adventure would terminate after the portion retained by the appellant was also sold and therefore the profits in the adventure could be determined only at the time of the completion of the sale of the entire estate. In our opinion, there is no justification for the assessee, cannot be ascertained even on the assumption that the transaction of the adventure of trade was not completed. Under the Income-tax Act for the purpose of assessment each year is a self-contained unit and in the case of trading adventure the profits have to be computed in the manner provided by the statute. It is true that the Income-tax

"In computing the balance of profits and gains for the purposes of income-tax.... two general and fundamental commonplaces have always to be kept in mind. In the first place, the profits of any particular year or accounting period must be taken to consist of the difference between the receipts from the trade or business during such year or accounting period and the expenditure laid out to earn those receipts. In the second

place, the account of profit and loss to be made up for the purpose of ascertaining the different must be framed consistently with the ordinary principles of commercial accounting, so far as applicable, and in conformity with the rules of the Income-tax Act, or of that Act as modified by the provisions and Schedules of the Acts regulating excess profits duty, as the case may be. For example, to ordinary principles of commercial accounting require that in the profit and loss account of a merchant's or manufacturer's business the values of the stock-in-trade at the beginning and at the end o

In *Commissioner of Inland Revenue v. Cock, Russell & Co. Ltd.* CroomJohnson J., in dealing with valuation of stock-in-trade for purposes of taxation, stated as follows :

"There is no word in the statutes or rules which deals with this question of valuing stock-in-trade. There is nothing in the relevant legislation which indicated that in computing the profits and gains of a commercial concern the stock-in-trade at the start of the accounting period should be taken in and that the amount of the stock-in-trade at the end of the period should also be taken in. It would be fantastic not to do it : it would be utterly impossible accurately to assess profits and gains merely on a statement of receipts and payments or on the basis of turnover. It has long been recognised that the right method of assessing profits and gains is to take into account the value of the stock-in-trade at the beginning and the value of the stock-in-trade at the end as two of the items in the computation. I need not cite authority for the general proposition which is admitted at the Bar, that for the purpose of ascertaining profits and gains the ordinary principles of commercial accounting should be applied

In *Commissioner of Income-tax v. A. Krishnaswami Mudaliar* it was observed by this court that whichever method of book-keeping was adopted in the case of a trading venture for computing the true profits of the year the stock-in-trade must be taken into account. At page 133 of the report Shah J., speaking for the court, stated the principle as follows :

"These observations do not affect the true character of the profits of a business. Adjustments may have to be made in the principle having regard to the special character of the assets, the nature of the business and the appropriate allowances permitted, in order to arrive at the taxable profits. They do not support the proposition that, in the case of trading venture, you can arrive at the true profits of a year by ignoring altogether the valuation of the stock-in-trade at the end of the year, while debiting its value at the commencement of the year as an outgoing; for determination of the profits by ignoring the valuation of the stock at the end of the year and debiting the value of the assets at the commencement of the year would not give a true picture of the profit for the year of account."

In view of this principle we are of the opinion that the income-tax authorities have correctly estimated the profit of the assessee by treating the land as stock-in-trade and valuing it according to the normal accountancy practice.

For the reasons expressed we hold that the decision of the High Court of Kerala dated 10th October, 1966, is correct and this appeal must be dismissed with costs.

Appeal dismissed.

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