M/s. A. R. Krishnamurthy and Another

Vs

C. I. T. MADRAS

Civil Appeal No. 2717 of 1985

(CJI R. S. Pathak, M. N. Venkatachaliah, Kuldip Singh JJ)

10.02.1989

JUDGMENT

KULDIP SINGH, J. -

1. The question in this appeal is whether the grant of a mining lease for a period of ten years by the assessee can give rise to a capital gain taxable under Section 45 of the Income Tax Act, 1961.

2. The assessee, a body of individuals, purchased two pieces of land in the year 1966 measuring 14.55 acres at a price of Rs. 27,260. By an instrument of lease-cum-licence dated September 10, 1970 they granted a mining lease in favour of M/s. Sri Krishna Tiles and Potteries (Madras) Private Limited (hereinafter called the 'Company'), an allied concern of the assessee. The lease was for a period of 10 yearn and the lessee had to pay a premium or salami of Rs. 5 lakhs in addition to the payment of royalty of Rs. 12 per hundred cubic ft. of clay extracted subject to a minimum of Rs. 60,000 per year.

3. The Income Tax Officer construed the lease deed as transferring a leasehold interest in the land in favour of the Company and came to the conclusion that the transfer was assessable to capital gains tax. For the purpose of computing the extent of tax the Income Tax Officer assessed the market value of the entire land at Rs. 8 lakhs. Since the leasehold interest was transferred for a sum of Rs. 5 lakhs, he valued the leasehold interest at 5/8th of the sale price of the entire land. On that basis the Income Tax Officer computed the cost of acquisition of the leasehold interest at Rs. 17,040, being 5/8th of Rs. 27,260. Thereafter deducting Rs. 17,040 from the sale consideration of Rs. 5 lakhs, he treated the sum of Rs. 4,82,960 as long term capital gains.

4. The assessee preferred an appeal to the Appellate Assistant Commissioner. The Appellate Commissioner held that the value of the right to excavate the land in terms of money is included in the purchase price paid by the assessee for the land. He rejected the argument of the assessee that the cost of acquisition of the said assets could not be determined. He then proceeded to consider the cost of acquisition of such right and differing with the Income Tax Officer held that on the facts of the case the cost for the purpose of ascertaining the capital gains would be the total price of the land paid by the assessee, that is, Rs. 27,260. On all other points he upheld the order of the Income Tax Officer.

5. The assessee preferred and appeal to the Tribunal. The Tribunal observed that the entire ownership of the property means the ownership of a bundle of rights and a limited interest which can be severed and disposed of for a specified period in the form of lease or mortgage or the like is part of that bundle. According to the Tribunal the purchase price paid by the assessee for the land

includes therein a component of purchase price attributable to various kinds of interests embedded in the said land. The Tribunal confirmed the order of the Appellate Commissioner and dismissed the appeal.

6. Arising from the said decision of the Tribunal, the following two questions were referred to the High Court for determination :

> (i) Whether, on the facts and in the circumstance of this case, the instrument of lease dated September 10, 1970 effected the transfer of a capital asset within the meaning of Section 45 of the Income Tax Act, 1961 and, accordingly, liable to capital gains tax ?
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> (ii) Whether, on the facts and in the circumstances of the case the Tribunal is right in law in holding that the cost of leasehold right is capable of valuation and, as such, capital gains can be computed ?

7. The High Court opined that the right conferred on the lessee under the lease deed was also a capital asset in the hands of the assessee-lessor. By giving a liberal meaning to the word "transfer" in Section 2(47) of the Act the High Court held that there was a transfer of capital asset for a consideration of Rs. 5 lakhs under the instrument dated September 10, 1970. It was further held that the rights of the owner of a land include a right to grant the lease for exploiting the land. The High Court answered the two questions in the affirmative and against the assessee. The High Court granted a certificate under Section 261 of the Act to appeal to this Court.

8. The relevant provisions of sub-section (14) of Section 2 which defines "capital asset" and Section 45(1) of the said Act which provides for the levy of tax on capital gains is as under :

> 2(14) "capital asset" means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include - ...
>
> 45(1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Section 53, 54 and 54-B be chargeable to income tax under the head "capital gains", and shall be deemed to be the income of the previous year in which the transfer took place.

9. Mr. Harish Salve, learned counsel appearing for the appellant, without disputing that the grant of a lease would constitute a transfer of an asset, has raised the following two contentions :

> (i) That conceptually there is no "cost of acquisition" which is attributable to the right of limited enjoyment transferred by the grant of the lease. There is no nexus between the "cost of acquisition" of the freehold lands and the right granted under the lease. For the same reason it is contended that there is no question of apportionment of such "cost of acquisition".
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> (ii) That since the cost of acquisition of the right granted under the lease cannot be determined the computation provisions under the Act cannot apply at all and as such Section 45 of the Act is not attracted. Reliance for this contention is placed on the judgment of this Court in CIT v. B. S. Srinivasa Shetty ((1981) 2 SCC 460 : 1981 SCC (Tax) 119 : (1981) 128 ITR 294).

> As regards the firs contention, Section 2(14) of the Act defines "capital asset" as "property of any kind held by an Assessee". What is parted with under the terms of the lease deed is the right to exploit the land by extracting clay which right directly flows from the ownership of the land. The land. The said right evaluated in terms of money forms part of the cost of acquiring the land. In Traders and Miners Ltd. v. CIT ((1955) 27 ITR 341 (Pat HC) a Division Bench of the Patna High Court, interpreting the expression "transfer of a capital asset" held as under :
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> We think that the expression "transfer" in the section included not only a permanent transfer but also a temporary transfer of title to the property in question and lease of mines for any period would fall within the ambit of Section 12-B of the Act. It was also contended by Mr. Dutt that a transaction of a lease was not tantamount to a transfer of title but that a mere contractual right was created. We do not think that this argument is correct. A lease of land is transfer of interest in the land and creates a right in rem; and there is a transfer of title in favour of the lessee though the lessor has right of reversion after the period of the lease terminates.

This decision has been referred to with approval by this Court in R. K. Palshikar (HUF) v. CIT ((1988) 3 SCC 594 : 1988 SCC (Tax) 444). If transfer of capital asset in Section 45 of the Act included grant of mining lease for any period then obviously the "cost of acquisition" of the land would include the "cost of acquisition" of the mining right under the lease. Undisputedly the grant of a lease being a transfer of an asset there is no escape from the conclusion that there is a live nexus between the "cost of acquisition" of the land and the rights granted under the lease. The amount of Rs. 27,260 paid by the assessee was not only the cost of acquiring the land but also of acquiring bundle of rights in the said land including the right to grant lease. There is, thus no force in the contention of the learned counsel that conceptually there is no "cost of acquisition" which is attributable to the right of limited enjoyment transferred by the grant of the lease. So far as the apportionment of the cost of acquisition is concerned it is a question of fact to be determined by the Income Tax officer in each case on the basis of evidence. The determination of the cost of the right to excavate clay in the land in terms of money may be difficult but is nonetheless of a money value and the best valuation possible must be made. Viscount Simon in gold coast Selection Trust Ltd. v. Humphrey (Inspector of Taxes) ((1949) 17 ITR 19 (Supp) (HL)) - observed "valuation is not an exact science. Mathematical certainty is not demanded, nor indeed is it possible." The Income Tax Officer in this case worked out the cost of leasehold interest by adopting the 5/8th ratio, though the Appellate Commissioner gave the benefit to the assessee of the full price of the land paid by him. In Traders and Miners Ltd. v. CIT ((1955) 27 ITR 341 (Pat HC) the Income Tax Officer had also determined the cost of the leasehold rights on proportionate basis. Once the cost of the leasehold rights is determined then there is no difficulty in making apportionment. We, therefore, do not find any force in the first contention of Mr. Salve and reject the same.

10. In view of our finding on the first contention the second contention does not survive. The value of leasehold rights in the cost of acquisition of land being determinable the computation provisions under the Act are applicable and Section 45 would be attracted. In Shetty case ((1981) 2 SCC 460 : 1981 SCC (Tax) 119 : (1981) 128 ITR 294) the question was whether the transfer of the goodwill of a newly commenced business can give rise to a capital gain taxable under Section 45 of the Act. This Court answered the question in the negative. Referring to the charging section and the computation provisions under the Act this Court held that none of those provisions suggest the inclusion of an asset under the head "capital gain", in the acquisition of which no cost at all can be conceived. Goodwill generated in an individual's business was held to be an asset in which no cost

element can be identified or envisaged. It was also held that the date of acquisition of the asset is a material factor in applying the computation provisions pertaining to capital gains and in the case of self-generated goodwill it is not possible to determine the same. The third reason for holding that the goodwill generated in a newly commenced business cannot be described as an 'asset' within the terms of Section 45 of the Act was that it is impossible to determine its cost of acquisition. None of the three reasons given by this Court in Shetty case ((1981) 2 SCC 460 : 1981 SCC (Tax) 119 : (1981) 128 ITR 294) are applicable in the present case. We have held that the cost of acquisition of leasehold rights can be determined. The date of acquisition of the right to grant lease had to be the same as the date of acquiring the freehold rights. The ration of Shetty case ((1981) 2 SCC 460 : 1981 SCC (Tax) 119 : (1981) 128 ITR 294) is thus not attracted to the question involved in the present case. We therefore, do not find any force in the present case. We, therefore, do not find any force in the second contention also.

11. Accordingly the appeal is dismissed with costs.

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