CALCUTTA HIGH COURT

K.N. Daftary

Vs

Commissioner of Income-Tax on

(S Deb and D Sen, JJ.)

13.05.1975

JUDGMENT

S Deb, J.

1. In this reference under Section 256(1) of the Income-tax Act, 1961, we are concerned with the following question of law :

> "Whether, on the facts and in the circumstances of the case, the sum of Rs. 5,045 received by the assessee for transfer of the 'import entitlements' was assessable to tax and, if so, as short-term capital gains ?"

2. The assessment year is 1964-65. The assessee carried on business in engineering goods. Under the export promotion scheme, he could get what are called "import entitlements" which would enable him to import raw materials to the extent of 75 per cent. of the f.o.b. value of the goods exported. Under this scheme, he could utilise the "import entitlements" for his own manufacture or could part with it to other manufacturers covered by the scheme. In the assessment year, the assessee received and transferred the "import entitlements" to two concerns for a total sum of Rs. 5,045. This amount was credited to the profit and loss account of the assessee and it was brought to tax by the Income-tax Officer.

3. It has been found by the Appellate Assistant Commissioner, on appeal, that the "import entitlements" were received by the assessee free of cost and as, in his opinion, the profits earned by the assessee on the sale of the "import entitlements" constituted a short-term capital gain, he directed the Income-tax Officer to make the assessment accordingly. The Tribunal, on second appeal, affirmed the said decision of the Appellate Assistant Commissioner.

4. Mr. Banerjee, the learned counsel for the assessee, has not disputed before us that "import entitlements" are "capital assets" within the meaning of Section 2(14) of the Income-tax Act, 1961. His first submission is that the cost of acquisition of the "import entitlements" cannot be ascertained and, therefore, these receipts are not capital gains, but no such contention was made before the Tribunal nor it arises out of the order of the Tribunal. It is a pure question of fact and, therefore, Mr. Banerjee is not entitled to take this new plea before us.

5. His other submissions are briefly as follows :

Section 48 overrides Section 45 of the Act and, therefore, these receipts are not capital gains because there was no cost of acquisition of these "import entitlements" ; and the term "capital gains" should be understood in the sense a trader would understand it, namely, the excess over the cost of acquisition and the sale proceeds, and, therefore, this case is outside the scope and purview of Section 45 of the Act.

6. In the cases of *Commissioner of Income-tax v. K. Rathnam Nadar*[1] Commissioner of Income-tax v. Chunilal Prabhudas & Co. , *Jagdev Singh Mumick v. Commissioner of Income-tax , Commissioner of Income-tax v. E.C. Jacob [FB]* and *Commissioner of Income-tax v. B.C. Srinivasa Setty*[2] cited by Mr. Banerjee, the goodwill of the businesses were sold and the cost of acquisition of the goodwill could not be ascertained at all and, therefore, it was held that those receipts were not taxable, because the profits or gains could not be computed at all.

7. Above cases were not decided on the basis that there was no cost of acquisition of the goodwill and, therefore, they do not assist Mr. Banerjee in any way. Further, goodwill and the "import entitlements" do not stand on the same footing and, therefore, no reliance can be placed by Mr. Banerjee on these cases. We may add here that in the case of *Commissioner of Income-tax v. Mohanbhai Pamabhai*[3] the Gujarat High Court has taken a different view from the cases cited by Mr. Banerjee.

8. We, however, agree with Mr. Banerjee that the term "capital gains" should be understood in the commercial sense, but we disagree with him that where the cost of acquisition of a capital asset in terms of money is nil the profit or gain arising out of the sale of such asset is not a capital gain in the commercial sense of that term, because all traders in no uncertain terms will say : "The entire sale proceeds is my profit and gain.'

9. Income includes capital gains chargeable under Section 45 of the Act. Section 45 and Section 48 of the Act are as follows :

"45. Capital gains.--Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 53 and 54, 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,

48. Mode of computation and deductions.--The income chargeable under the head 'Capital gains' shall be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely :--

(i) expenditure incurred wholly and exclusively in connection with such transfer;
(ii) the cost of acquisition of the capital asset and the cost of any improvement thereto."

10. The submission of Mr. Banerjee is that Section 48 of the Act cannot be applied in this case because there is no cost of acquisition of the capital asset and, therefore, Section 45 of the Act has no application. In support of this contention he has placed strong reliance on the dissenting judgment of Lord Chancellor Cave in the case of Whitney v. Commissioners of Inland Revenue

[1925] 10 TC 88 (HL). In that case, the assessee was a non-resident and the question before the House of Lords was whether he was liable to pay super-tax on the income accrued to him in England. It was contended on his behalf that he was not liable to pay such tax because there was no provision in the Act for service of a notice by registered post on the nonresident assessee, but the House of Lords overruled that contention, and yet, Mr. Banerjee has relied on the following observation of the Lord Chancellor at page 108 of the report:
"If the machinery provided for assessment is not applicable to the case, then there is no power to tax."

11. But the above observation has no application whatsoever to the instant case before us, because the question of failure of any machinery can never arise here. That apart, in that case, at page 110 of the report, Lord Dunedin says as follows :

"My Lords, I shall now permit myself a general observation. Once that it is fixed that there is liability, it is antecedently highly improbable that the statute should not go on to make that liability effective. A statute is designed to be workable, and the interpretation thereof by a court should be to secure that object, unless crucial omission or clear direction makes that end unattainable. Now, there are three stages in the imposition of a tax: there is the declaration of liability, that is the part of the statute which determines what persons in respect of what property are liable. Next, there is the assessment. Liability does not depend on assessment. That, ex hypothesi, has already been fixed. But assessment particularises the exact sum which a person liable has to pay. Lastly, come the methods of recovery, if the person taxed does not voluntarily pay." (Underlined for emphasis).

12. A section prescribing the method of computation cannot override the charging section. In the computation, many items may be allowed or disallowed and many items may be added, but the section prescribing the mode of computation of taxable income, profit or gain does not and cannot determine the statutory liability of the assessee to pay the tax. It can never be said that no tax is payable merely because the assessee is not entitled to a particular deduction or he is unable to claim a particular deduction for some reason or other. Therefore, there is no merit in the contention that where there is no cost of acquisition of the capital asset the profits or gains arising out of the sale of such asset is outside the scope and purview of Section 45 of the Act.

13. Section 45 is the charging section. It declares the liability to pay capital gains. Section 48 prescribes the mode of computation and it allows the deductions specified therein, and before any such deductions can be allowed it must be shown by the assessee that he is entitled to those deductions by proving the actual expenditure incurred by him. Where, as in this case, the cost of acquisition of the capital assets in terms of money is nil the assessee is not entitled to any deduction for it.

14. In this connection, we may observe here that Mr. Banerjee was inspired to make the above submissions in view of the following observations on Section 12B(2)(ii) of the Indian Income-tax Act; 1922, of their Lordships of the Madras High Court in the case of *Commissioner of Income-tax v. K. Rathnam Nadar*[4] "Sub-clause (ii) of Sub-section (2) may suggest that the capital gain arises only on the transfer of a capital asset which has actually cost to the assessee something in money. The actual cost in the context of the Income-tax Act can only be cost in terms of money. It cannot, it would appear, apply to transfer of capital assets (assuming that the goodwill is a

capital asset, about which there was not much dispute), which did not cost anything to the assessee in terms of money in its creation or acquisition."

15. Another source of his inspiration is the case of Commissioner of Income-tax v. Chunilal Prdbhudas & Co. for, in that case, Mukharji J. (as he then was) has relied on the above observations of their Lordships of the Madras High Court but, as already stated, in the case before Mukharji J., the cost of acquisition of the goodwill of the business could not be determined at all. In other words, the cost of acquisition of the goodwill in that case was not nil in terms of money and, therefore, it was wholly unnecessary for Mukharji J. to rely on the above observations of their Lordships of the Madras High Court.

16. That apart, the above observations of their Lordships of the Madras High Court, if correct, will nullify Section 45 of the Act in all such cases where there is no cost of acquisition of the capital asset nor any improvement is made thereto. But Section 45 of the Act cannot be set at naught in that way. Further, it is not always impossible to value the goodwill which is undoubtedly a capital asset. And this illustration will make the position abundantly clear : Suppose A purchases the goodwill of a business for Rs. 50,000 and the business for Rs. 1 lakh and on the next day he sells the goodwill at Rs. 60,000 and the business at Rs. 1,10,000 and no one will dispute that A has made a capital gain of Rs. 10,000 on sale of goodwill.

17. The "import entitlements" were acquired and sold in the previous year. The cost of their acquisition in terms of money was nil. Therefore, in the facts and circumstances of the case, the short-term capital gain has been rightly determined at Rs. 5,045. Hence, we overrule the contentions of Mr. Banerjee and return our answer in the affirmative and in favour of the revenue.

18. In the facts and circumstances of the case, we make no order as to costs.
Dipak Kumar Sen, J.

18. I entirely agree with the judgment just now delivered by my learned brother and the conclusions recorded. Speaking for myself I only wish to add that in Chunilal's case [1970] 76 ITR 566 (Cal) this court considered Section 12B of the Indian Income-tax Act, 1922, in the context of goodwill. Mukharji J. (as he then was) held regarding goodwill as follows :

(a) Goodwill fails in all the tests of a capital asset;
(b) Goodwill is not a capital asset with which a business is started;
(c) Goodwill is not a capital asset which can be divided into parts or fragments;
(d) Goodwill cannot exist independently de hors the business itself and does not have any value apart from the business which necessarily includes other usual capital assets.

19. On the basis of the above his Lordship was pleased to hold that goodwill did not fall and was not intended to be brought within the ambit of the section as taxable capital gains.

20. The question of expenditure necessary to acquire goodwill was also considered and the finding was that from the practical point of view and also legally it was not possible to separate the actual cost of the goodwill in the assessee's capital assets and also it was not possible to separate the actual cost incurred for making any addition or alteration to such goodwill. On the

basis of the above, it was held that goodwill was excluded from the concept and ambit of Section 12B.

21. After coming to this conclusion Mukharji J. was pleased to cite the passage from the judgment of the Madras High Court in the case of Rathnam Nadar [1969] 71 ITR 433 (Mad) in support of the conclusion already arrived.

22. It appears to me it was not necessary in the facts of Chunilal's case to come to any general conclusion regarding the actual cost, if any, incurred in acquiring a capital asset. If it be contended that in quoting the said judgment of the Madras High Court this court intended to lay down generally that in all cases where there was no actual cost to acquire a capital asset then there would be no capital gain in any subsequent dealing with the said capital asset, then I would hold that this proposition, if so laid down, is obiter.

Cases Referred.

1[1969] 71 ITR 433 (Mad)
2[1974] 96 ITR 667 (Kar)
3[1973] 91 ITR 393 (Guj)
4[1969] 71 ITR 433, 445 (Mad)