(1981) 07 GUJ CK 0027

Gujarat High Court

Case No: IT Reference No. 377 of 1977

Commissioner of Income Tax		APPELLANT
	Vs	
Ashaland Corporation		RESPONDENT

Date of Decision: July 22, 1981

Acts Referred:

- Income Tax Act, 1961 - Section 14, 2(24), 256(1), 263(1), 4
- Transfer of Property Act, 1882 - Section 53A

Citation: (1981) 7 TAXMAN 393

Hon'ble Judges: R.C. Mankad, J

Bench: Single Bench

Advocate: S.N. Shelat and R.P. Bhatt, for the Appellant; K.C. Patel, for the Respondent

Judgement

Mankad, J.
The income tax Appellate Tribunal (hereinafter referred to as "the Tribunal") has, at the instance of the revenue, referred the following questions for our opinion u/s 256(1) of the income tax Act, 1961 (hereinafter referred to as "the Act"):

Whether, on the facts of the case, the Tribunal was right in law in holding, (i) that the amount of Rs. 5,000 received by the assessee as earnest money constituted its income taxable for the assessment year 1971-72, (ii) that the amount of Rs. 2,08,772 received by the assessee as part price constituted its income taxable for the assessment year 1971-72?

Facts leading to this reference briefly stated are as follows. The, assessee, a partnership firm, is a dealer in land. It purchased land bearing S. Nos. 122/1, part of S. No. 122/2 and S. No. 124 situate on Harni Road in the outskirts of Baroda City on March 15, 1967. Out of this land, a portion of the land was sold by the assessee to a housing society in 1968, but that sale is not relevant for the purpose of this reference. On November 14, 1970, the assessee entered into an agreement to sell a certain number of plots out of the said land to Avinash Co-operative Housing Society

(hereinafter referred to as "the society"). At the time of the agreement, the assessee received Rs. 5,000 by way of earnest money. Between December 25 and 28, 1970, the assessee received a further sum of Rs. 2,08,772 towards the sale price from the society and handed over the possession of some of the plots out of the plots agreed to be sold to the society. The total sum of Rs. 2,13,772 received by the assessee from the society was credited to the trading account in the previous year relevant to the assessment year 1971-72. The question which arises for our consideration whether the receipt of the amount of Rs. 2,13,772 represents the assessee''s income earned in the said year. The relevant year of account is the calendar year 1970.

2. In its return of income for the assessment year 1971-72, the assessee disclosed a net profit of Rs. 90,403 derived from the receipt of the aforesaid amount of Rs. 2,13,772 as its income. The ITO substantially accepted the return subject to the disallowance of expenses of Rs. 597. The total income of the assessee for the assessment year 1971-72 was computed at Rs. 91,000. While examining the records of the assessment proceedings for the assessment year 1971-72, the Commissioner of income tax was of the view that the ITO had committed an error in accepting the return. He, therefore, in exercise of his powers u/s 263(1) of the Act, issued a notice calling upon the assessee to show cause why the assessment should not be reopened and why the ITO should not be directed to make a fresh assessment after taking into account all the relevant facts and material. The assessee resisted the proposed action of the Commissioner and contended that since it was maintaining accounts on cash basis, receipt of Rs. 2,13,772, credited to the trading account, was its income earned in the relevant year of account. It was stated that the sale deeds in respect of the plots of land agreed to be sold were executed on different dates between February 26, 1971, and June 26, 1972, for a total consideration of Rs. 4,40,939. It is not in dispute that the sale transactions with the society were completed in the year of account relevant to the succeeding assessment year, namely, assessment year 1972-73. It was, however, contended that since the assessee was maintaining accounts on cash basis, the income returned by the assessee and assessed by the ITO for the assessment year 1971-72 was correct. According to the Commissioner:
The real question which is required to be decided is whether the sale took place during the previous year 1970, and, therefore, the receipts could be treated as part of the sale proceeds on which a proportionate profit could be assessed in the assessment year 1971-72?

3. The ITO, however, had not addressed himself to this question. The Commissioner observed that since the sale deeds were executed in the subsequent year, namely, calendar year 1971, the entire profit arising from the sale transaction would probably be liable to be taxed in the assessment year 1972-73. Under the circumstances, the Commissioner set aside the assessment made by the ITO and directed him to make a fresh assessment for the year 1971-72 after bringing on

record all the relevant materials necessary for the assessment and considering the same in accordance with law.

4. Being aggrieved by the order passed by the Commissioner, the assessee went in appeal before the Tribunal. The Tribunal held that having regard to the method of accounting followed by the assessee, the amount of Rs. 2,13,772 received under the agreement dated November 14, 1970, in the calendar year 1970 represented the assessee''s income earned in the said year, even though the actual sale deeds for a total consideration of Rs. 4;40,939 were executed and registered in favour of the society only in the year 1971. In the result, the Tribunal allowed the assessee''s appeal and set aside the order passed by the Commissioner. It is in the background of these facts that the question set out above has been referred to us for our opinion u/s 256(1) of the Act.

5. Section 4 of the Act imposes income tax upon a person in respect of his income. In other words, the income tax is a tax on a person in relation to his income. "Income" as denned in section 2(24) includes profits and gains. Section 14 of the Act enumerates six heads under which the income of an assessee falls to be charged. One of such heads is "Profits and gains of business or profession". So far as the instant case is concerned, we are concerned with profits and gains of business. Now, the word "profits" is to be understood as observed by Lord Halsbury in Gresham Life Assurance Society v. Styles [1892] 3 TC 185, 188 (HL), "in its natural and proper sense-in a sense which no commercial man would misunderstand". The observations of the Privy Council in Pondicherry Railway Co. v. CIT [1931] 5 ITC 363 and of the Supreme Court in Badridas Daga Vs. The Commissioner of Income Tax, , Calcutta Company Ltd. Vs. The Commissioner of Income Tax, West Bengal, and Commissioner of Income Tax, Bombay City I, Bombay Vs. Bai Shirinbai K. Kooka, show that the profits to be assessed are real profits and they must be ascertained on the ordinary principles of commercial trading and commercial accounting. What are chargeable to income tax in respect of business are profits of the previous year. Therefore, the question which arises in the instant case is, whether the assessee had earned any profits in the previous year relevant to the assessment year 1971-72, which are chargeable to income tax. The assessee is a dealer in land. In other words, its business is purchase and sale of land. Therefore, the profits which it would derive from the transactions of purchase and sale of land would be its profits of business chargeable to income tax. The land is stock-in-trade of the assessee. When the assessee purchases land, such land would become part of its stock-in-trade. The land would cease to be its stock-in-trade when it would sell it. In other words, the land purchased by the assessee which forms part of its stock-in-trade, would continue to be its stock-in-trade, until and unless, it sells it. The assessee would continue to be the owner of the land which it has purchased and which is part of its stock-in-trade, till it is divested of the ownership by completion of the sale transaction. The business deal in respect of a land owned by the assessee would be complete only when it executes a registered sale deed. It is only on completion of

the sale transaction in respect of the land owned by the assessee that the assessee could be said to have earned profit or suffered loss, as the case may be. The assessee purchased the land, a portion of which is the subject-matter of dispute before us, on March 15, 1967. On and from the date of purchase, the land became part of the stock-in-trade of the assessee. The land which forms part of the stock-in-trade of the assessee would not, as observed above, cease to be so unless the assessee sells it. And sale would not be complete unless it executes a registered sale deed. Admittedly, no sale transaction took place in the previous year relevant to the assessment year 1971-72. All that happened in that year was that the assessee entered into an agreement to sell certain plots of land out of the land purchased by it in 1967 to the society under the agreement dated November 4, 1970. Since no actual sale took place in that year, land or any portion thereof which was the subject-matter of the agreement did not cease to be the stock-in-trade of the assessee in that year. It is, however, contended on behalf of the assessee that in pursuance of the agreement for sale, it had received Rs. 5,000 by way of earnest money and Rs. 2,08,772 as advance towards the total sale price of the land agreed to be sold. These receipts, says the assessee, are its trading receipts and, therefore, they represent its gross income earned in the previous year relevant to the assessment year 1971-72. It is contended that since the business of the assessee is to purchase and sell land, it is immaterial as to when the sale deeds in respect of the land agreed to be sold are executed. Whatever it receives in advance towards the sale price between the agreement to sell and execution of the registered sale deeds is nothing but trading receipt. It is further contended that such trading receipts represent the assessee''s income earned on the date on which they are received. We are unable to accept this argument. All receipts are not income. In order to partake of the character of income, receipt must be part of the profits earned by the assessee. In other words, the receipt must assume the character of income before it becomes exigible to income tax. The assessee undoubtedly received a total sum of Rs. 2,13,772 in advance towards the sale price of the land which it had agreed to sell to the society, but can this receipt be considered to be its income? The answer must be emphatically "no". Business of the assessee, as pointed out above, is to purchase and sell land. Unless the title of the assessee is extinguished, the title of the purchaser cannot arise. Both cannot be the exclusive owners of the same property at the same time. So long as the assessee continues to be the owner, how can it be said that his title is divested and the sale has resulted in any profit to him? It is axiomatic that an agreement to sell does not create any interest in favour of the purchaser. It is on completion of the transaction of purchase and sale culminating in the extinguishment of the title of the vendor and simultaneous creation of the title in the vendee that the assessee earns profit or suffers loss. A transaction which may or may not ultimately result in a completed sale by executing a registered conveyance, is no transaction at all for the purpose of working out profit. Receipt of Rs. 2,13,772 would assume the character of income or profit only when the sale transaction is completed in accordance with law. It is the transfer of title in land to

the purchaser which completes the transaction of sale. It was argued that while accepting Rs. 2,08,772 towards part payment of sale price, the assessee had parted with possession of some of the plots of land agreed to be sold. Parting with possession of the land, it was urged, would in any case make the receipt of the aforesaid amount a trading receipt. We are afraid, we cannot accept this argument also. The receipt of a part payment of price coupled with the parting of possession of some portion of the land agreed to be sold would not confer any title on the purchaser, i.e., the society, even in respect of the land of which possession is given to it. Doctrine of part performance cannot be brought into aid to treat the receipt of Rs. 2,13,772 as a trading receipt. Doctrine of part performance embodied in section 53A of the Transfer of Property Act has a limited application and it affords only a good defence to the person put in possession under an agreement in writing to protect his possession to the extent provided in the said section 53A of the Transfer of Property Act; but, in any case, the agreement in writing to sell, coupled with parting of possession, would not confer any legal title on the purchaser and take the land out of the stock-in-trade of the seller if he is a dealer in land. If a mere agreement of sale were to be treated as creating any such right as contended by the assessee, it would create many complications which would be difficult to resolve. For example, can a person who has agreed to sell his property, exclude the value of such property from his net wealth while filing return of his net wealth? Would the person who has agreed to purchase land be liable to include property in his net wealth, even though no sale deed is executed in his favour? Both the questions shall have to be answered in the affirmative, if the contention of the assessee were to be accepted. We have, however, no manner of doubt that the answer to both the questions is in the negative, for, as discussed earlier, the title of the assessee still subsists and that of the purchaser is yet to arise. Whether or not to include the property in the net wealth depends upon, who is the owner of the property. A mere agreement to sell does not confer any title on the person who has agreed to purchase or divest the person who has agreed to sell off his title. Let us take another example : "A" agrees to sell his property to "B", but before the sale deed could be executed, the property is destroyed in fire, who would suffer the loss resulting from the fire-"A" or "B"? Answer is obviously "A", because title has not been passed on to "B", there being no completed sale. In the same example, if after the execution of the agreement to sell and before the execution of the sale deed "B" dies, would the value of the property agreed to be sold be liable to be included in the dutiable estate of "B"? Here also, the answer is in the negative, because "B" had not acquired any legal title over the property.

6. In the illustrations which we have given above, the vital question to be answered is, who is the owner of the property or in whom the title to the property vests. In the case of a person who is a dealer in land, the business transaction would be completed only when the purchase or the sale transaction is complete. In order to decide whether the business transaction is complete, the question of vital

importance is whether title in the property has passed. It is only on the passing of the title that the transaction becomes complete, and unless the transaction is complete, an advance receipt of money towards the transaction would not form part of the income or profit. In other words, the receipt would partake of the character of income only when the transaction is complete.

7. We are unable to see how the method of accounting has any relevance in determining whether the receipt of the two amounts, as aforesaid, by the assessee is a trading receipt or income. Even assuming for the sake of argument that the method of accounting which the assessee follows is the cash method, it would have a bearing only in respect of completed business transactions. If the method followed is the cash method, only amounts which the assessee has received will form part of its income, but that would be so only after the transactions in respect of which the amounts are received are legally completed. Such amounts cannot be treated as trading receipts till the title passes to the purchaser and the land for which the amount is received goes out of the stock-in-trade of the assessee. If the method of accounting followed is mercantile, on completion of the transaction the entire sale price will become the income of the assessee irrespective of the fact whether or not he actually received it. But, in either case, there is no question of the receipt becoming an income before the completion of the transaction and a transfer of the title. The real test in deciding whether the receipt is the assessee''s income or not, is whether the assessee continues to be the owner of the land, or whether he is divested of such ownership. The land of which the assessee is the owner is its stock-in-trade and the land which is sold, i.e., the land of which the ownership or title is transferred, ceases to be its stock-in-trade only when the transaction is complete. In our opinion, therefore, even assuming that the method of accounting followed by the assessee is the cash method, the amount of Rs. 2,13,772 which it received towards the sale price is not its trading receipt, since the lands towards the price of which the said amount was received were not sold in the previous year relevant to the assessment year 1971-72. As pointed out above, the sale deeds were admittedly executed in the previous year relevant to the assessment year 1972-73. Therefore, no part of the amount of Rs. 2,13,772 formed part of the trading receipt of the assessee in the previous year relevant to the assessment year 1971-72.

8. A similar question in a different context had arisen before us in income tax Reference No. 232 of 1976, decided on March 24/25, 1981. Commissioner of Income Tax, Gujarat-IV Vs. Shah Doshi and Co., . In that case, the assessee-firm, trading in land, had entered into an agreement to purchase land from a firm, M/s. Shah & Company. The assessee entered into another agreement with Mai Krupa Co-operative Housing Society Ltd. to sell the land which it had agreed to purchase from M/s. Shah & Co. The right which the assessee acquired under the agreement with M/s. Shah & Co. was sought to be treated as its stock-in-trade. The question which arose before us in that case was whether as a result of the agreement with M/s. Shah & Co., the assessee had acquired any stock-in-trade. This court took the

view that, since the assessee was a dealer in land, only such land which it acquired in the course of its business would form part of its stock-in-trade. It was observed that a mere agreement to purchase land would not confer any title on the assessee and the land agreed to be purchased could not be treated as its stock-in-trade unless and until the sale transaction was complete. The stock which the assessee had contracted to purchase, and which might have been appropriated to the contract, but the property in which has not passed to the assessee, cannot be regarded as the assessee''s stock-in-trade. The instant case before us is a converse case. Here, what is argued on behalf of the assessee is that on and from the date of the agreement to sell the land to the society, the land ceased to be its stock-in-trade and, therefore, the amount received by it towards the sale price should be treated as its income. As pointed out above, the land does not cease to be the stock-in-trade of the assessee unless and until the sale is completed. Therefore, the amount received by the assessee by way of earnest money and part payment of the purchase price cannot be treated as its trading receipt.

9. A question similar to the one which has arisen before us had come up for consideration in the case of CHIDAMBARAM CHETTIAR Vs. COMMISSIONER OF Income Tax, MADRAS., . That was a case, in which the assessee, who was carrying on business at Klang (in Burma), had entered into an agreement with one S. A. Rm., who carried on business at Penang, for the purchase of house sites belonging to S. A. Rm in British India. On 3rd April, 1929, a sum of Rs. 50,000 was paid to S. A. Rm at Penang by the assessee''s Klang firm towards the price and the assessee was debited with this amount on that date. The sale deed was executed on 8th May, 1929. In the assessment for the accounting year 13th April, 1929, to 12th April, 1930, the assessee contended that this sum of Rs. 50,000 must be deemed to have been remitted to him on 3rd April, 1929, and not on 8th May, 1929, and that it could not, therefore, be included in the income of the year ending 12th April, 1930. On a reference, the Madras High Court took the view that the assessee received the money in the shape of house sites only on the 8th May, 1929, and so the amount was liable to be assessed to tax in the accounting year ending 12th April, 1930. In other words, it was held that the assessee could not be said to have received money, unless and until the sale was completed on May 8, 1929. Similar view was taken KUNJAMAL AND SONS, IN RE., . We are, therefore, unable to agree with the view taken by the Tribunal that the amount of Rs. 5,000 received by the assessee as earnest money and Rs. 2,08,772 received by it as part payment of price constitute the assessee''s income taxable for the assessment year 1971-72. We, accordingly, answer the question referred to us in the negative and against the assessee with no order as to costs.