Commissioner of Income Tax Vs Shivsagar Estates (Aop)
 Shivsagar Estates (Aop) Vs Commissioner of Income Tax

Court: Bombay High Court

Date of Decision: March 1, 1993

Acts Referred: Income Tax Act, 1961 â€" Section 4

Citation: (1993) 204 ITR 1

Hon'ble Judges: U.T. Shah, J; Sujata V. Manohar, J

Bench: Division Bench

Advocate: G.S. Jetly and Dilip Dwarkadas, for the Appellant;

Judgement

U.T. Shah J.

1. These two cross-references invoking, inter alia, a common point of dispute are disposed of together for the sake of convenience.

2. The assessment years involved are 1970-71, 1971-72 and 1972-73 and the relevant previous years are the corresponding financial years

ended on March 31, 1970, March 31, 1971, and March 31, 1972, respectively.

3. As the issue raised in the question referred to us, at the instance of the Revenue, is covered by an earlier decision of this Court, well will take up

the Revenue''s reference first.

4. The material facts are : Sixty-five members of three families of Dhanwatay, Patel and Shah jointly purchased a vast area of land at Worli, in

November 1963. This was divided into eight plots marked A to H. Plots A to F were given on lease to Messrs. Shivsagar Estates Limited, in April

1966, on an annual rent of Rs. 15 lakhs payable separately to each of the lessors in accordance with their respective shares. In the assessment

years 1967-68, 1968-69 and 1969-70, the lease rent from the said property, which was renamed Shivsagar Estates, was the only source of

income and it was assessed to tax in the hands of an association of persons comprising these sixty-five individuals. This status was upheld by the

Appellate Assistant Commissioner of Income Tax (""the AAC""), but the Income Tax Appellate Tribunal (""the Tribunal"") held that there was no

association vis-a-vis the lease rent and that the sixty-five persons were individually assessable on their respective shares. Broadly stated, this

decision was based on the finding that each of the sixty-five co-owners had a specific and definite share and that none of the necessary and

essential ingredients for the formation of an association, namely, volition, joint enterprise, joint management, joint accrual and joint receipt of

income was present in the case. One of the circumstances on which the Revenue had laid considerable stress was that these sixty-five persons had

not merely purchased the vast area and given it one lease, but they had also set about developing their estate as a first class commercial and

business locality, including plans for setting up of a hotel of a international standard in collaboration with the world famous Hilton Hotels

International Incorporated. The proposed hotel was to be named ""The Metropolitan Hotels Limited"". It may be mentioned that this proposed hotel

was to be constructed on plot H, which we have to consider separately while dealing with the reference preferred by the assessee.

5. On the aforesaid facts, the Tribunal has referred the following question at the instance of the Revenue :

Whether, on the facts and in the circumstances of the case and in law, the Tribunal was right in holding that the lease rent from the property known

as Shivsagar Estates (plots A to F) accrued to the individual co-owners and not to an association of persons ?

6. At the time of hearing, both the parties agreed and stated that the issue involved in the aforesaid question has been recently decided by this

Court in the assessee''s own case for the assessment years 1967-68 to 1969-70 in Income Tax Reference No. 231 of 1977, dated 17th/18th

December, 1992 Commissioner of Income Tax Vs. Shiv Sagar Estates (Aop), to which one of us (Shah J.) was a party. In the said decision, the

High Court has upheld the decision of the Tribunal holding that the rent received from the property known as Shivsagar Estates (plots A to F)

accrued to the individual co-owners and not to an association of persons consisting of these people.

7. As no new facts/materials are obtaining in the years under reference, following the aforesaid decision, we answer the question referred to us, at

the instance of the Revenue, in the affirmative, i.e., in favour of the assessee and against the Revenue.

8. Now, we shall deal with the reference made at the instance of the assessee. The aforesaid sixty-five persons took a loan of Rs. 40 lakhs

(maximum limit) from the First National City Bank on the negative lien of plot H, wherein all of them were interest as co-owners. The agreement

the co-owners entered into with the bank on September 13, 1971, in respect of this loan was with Shri Vasantray Dattaji Dhanwatay for himself

and his group of co-owners, Shri D. Chhaganlal Shah for himself and his group of co-owners and Smt. Lilaben Manibhai Patel for herself and her

group of co-owners. The loan was secured by the joint and several promissory notes and undertaking by each of these persons acting as the

respective attorney or agent of their respective group and by collateral security by way of deposit of title deeds relating to plot H. It may be

mentioned that the amount of loan drawn periodically had been debited by the bank to the loan account in the same bank opened on September

26, 1969, in the names of the co-owners. From this current account substantial amounts were also transferred to the account of Sangli Bank in the

name of Messrs. D. C. Shah, M. H. Patel and V. D. Dhanwatay, co-owners, of Shivsagar Estates.

9. Considering the aforesaid peculiar facts obtaining in respect of plot H, the Income Tax Officer came to the conclusion that the sixty-five parsons

formed an association of persons to exploit the said property as a business venture. In this connection, he referred to an agreement entered into

between the persons and Messrs. Metropolitan Hotels Limited dated June 9, 1969, the relevant portions of which are to be found in the

assessment order for the assessment year 1972-73 :

(1) The lessees are constructing a five star international hotel in technical collaboration and assistance with Hiltons in accordance with the sanction

of the Municipal Corporation.

(2) Licence shall commence from April 1, 1969, and the licensees shall pay the annual licence fee for compensation of Rs. 7,80,000 payable on

the first January, 1st April, 1st July and 1st October of every year, the first such instalment commencing on the 1st October, 1970, without any

deduction or abatement.

(3) The licence shall be for a period of five years commencing from April 1, 1969, on the expiry of which lease of the sub-plot shall be granted.

During the licence period no tenancy rights shall be granted.

(4) The licence shall pay to the assessee a sum of Rs. 23,40,000 on or before March 31st, 1970, or such other date as mutually agreed upon free

of interest. The amount shall be set off at the rate of Rs. 2,80,000 per annum or Rs. 70,000 per quarter against the licence fee and the balance of

Rs. 5,00,000 shall be payable in quarterly instalments every year.

10. Messrs. Metropolitan Hotels Limited had spent considerable amounts towards preliminary expenses of the project for the development of the

plot and construction of the retention wall on the side of the high seas and they also started construction of the hotel building. About Rs. 51 lakhs

were spent by Messrs. Metropolitan Hotels Limited in this regard. However, the foreign collaborators, namely, Hilton Hotel International, gave up

their interest in the project on account of sewage odour in the vicinity. The entire expenditure, therefore, proved to be wasteful expenditure as far

as the licensees were concerned. In fact, the licensees were not able to pay to the assessee compensation up to December 13, 1971, and they

therefore called upon the assessee to terminate the licence and an agreement dated January 28, 1972, was entered into terminating the licence. The

relevant clause of the said agreement reads as under :

2. That in consideration of the licensee handing over the possession of the said plot and all the said construction including retention wall and in

consideration of the licensees giving up their right to the grant of the lease of the said plot the licensors had hereby agreed and declared to waive

their right to receive compensation and the licensors have also agreed not to charge any interest on the individual loans given by them to the

licensees to enable it to develop the said plot and put up the structure on the same.

11. On the aforesaid facts, the assessee took up the stand before the Income Tax Officer that there was no association of persons for exploiting

plot H, that no income had arisen to it either by way of lease rent or interest on advances made to Messrs. Metropolitan Hotels Limited, and that in

any event, in view of the terms and conditions of the agreements dated January 28, 1972, no income had arisen or accrued to the assessee as the

assessee had agreed to waive its rights of receiving compensation/interest from Messrs. Metropolitan Hotels Limited. It was also stated that after

the termination of the said agreement, another agreement was entered into between the assessee and Messrs. Poonam Hotels Limited and

whatever amount the assessee received from Messrs. Poonam Hotels Limited was handed over to Messrs. Metropolitan Hotels Limited. In other

words, the assessee wanted to impress upon the Income Tax Officer that it was for business consideration and commercial expediency that it gave

up the right to receive the lease rent or interest from Messrs. Metropolitan Hotels Limited.

12. The Income Tax Officer, however, was not inclined to accept the assessee''s contention, as according to him, giving up of the lease rent and

the interest was not just a commercial expediency. Further, according to him, nothing had been forgone by the assessee. One the contrary, instead

of receiving the licence fees and interest in cash the assessee had received certain portion is kind which was constructed by Messrs. Metropolitan

Hotels Limited at a high cost, including the retention wall to prevent the sea water entering into the land area. All these developments, according to

the Income Tax Officer, ""were admittedly benefits of a permanent nature considerably enhancing the value of the plot"". He, therefore, included the

lease rent of Rs. 3,90,000 in the assessment year 1971-72 and Rs. 6,50,000 in the assessment year 1972-73 in respect of plot H in the total

income of the assessee. Further, he also included the interest on the monies advanced to Messrs. Metropolitan Hotels Limited in the total income

of the assessee on accrual basis.

13. Before the Appellate Assistant Commissioner, the assessee contested that the Income Tax Officer was not justified in adopting the status of

association of persons in respect of the income earned on plot H. After giving the background in which the assessee had entered into the

agreement with Messrs. Metropolitan Hotels Limited and the circumstances under which that agreement was terminated, coupled with the fact that

Messrs. Metropolitan Hotels Limited was passing through a financial crisis, the assessee submitted before the Appellate Assistant Commissioner

that in any event, since the income in respect of plot H was given up on commercial expediency and with a view to take back plot H from Messrs.

Metropolitan Hotels Limited, the income included by the Income Tax Officer should be deleted from its total income. In this connection, reliance

was placed on the decision of this Court in the case of H.M. Kashiparekh and Co., Ltd. Vs. Commissioner of Income Tax, Bombay North, Kutch

and Saurashtra, and the decision of the Supreme Court in the case of Commissioner of Income Tax, Bombay City I Vs. Shoorji Vallabhdas and

Co., . The Appellate Assistant Commissioner, however, upheld the action of the Income Tax Officer in treating these sixty-five persons as an

association of persons in respect of plot H. However, he gave a clear and categorical finding that since the assessee was not maintaining any books

of account whatsoever, there is no question of accrual of income as was held by the Income Tax Officer. According to the Appellate Assistant

Commissioner, under these circumstances, when no books of account were maintained by the assessee, the best course would be to make a best

judgment assessment estimating the income of the assessee from plot H. However, in view of the subsequent development that Messrs.

Metropolitan Hotels Limited was not in a position to complete the project of construction a hotel of an international standard in collaboration with

Hilton Hotel International Incorporated and the fact that Messrs. Metropolitan Hotels Limited had requested the assessee to terminate the

contract, etc., etc., the Appellate Assistant Commissioner, relying on the aforesaid two decisions, held that the doctrine of real income would be

applicable in the instant case. According to him, on the proper appreciation of the facts and circumstances obtaining in the case, there was no

justification for estimating any income as was done by the Income Tax Officer. He, therefore, deleted the income included by the Income Tax

Officer in the total income of the assessee in respect of plot H.

14. Aggrieved by the action of the Appellate Assistant Commissioner, both the assessee as well as the Revenue came up in appeal before the

Tribunal. The assessee''s grievance was that the Appellate Assistant Commissioner should have held that there was no association of persons, vis-

a-vis, plot H as was held by him in respect of plots A to F. The Revenue came up with a grievance that the Appellate Assistant Commissioner

ought not to have deleted the income (lease rent and interest) in respect of plot H from the total income of the assessee.

15. In its order under reference, the Tribunal upheld the order of the Appellate Assistant Commissioner treating the assessee as an association of

persons, vis-a-vis, plot H. However, as regards the inclusion of income from the said plot, the Tribunal agreed that the agreement dated January

28, 1972, entered into between the assessee and Messrs. Metropolitan Hotels Limited cannot be doubted and that all material and documents

placed before it were genuine documents and were duly acted upon by the parties. Further, the Tribunal held that it was not able to subscribe to

the submission made on behalf of the Revenue that ""there has been no effective forgoing of the lease rent because of the structures on the leased

plot valued at Rs. 26 lakhs, having been handed over by the Metropolitan Hotels Ltd. to the assessee on the termination of the lease"". The

Tribunal, however, did not approve the action of the Appellate Assistant Commissioner on this point, on the ground that the termination of the

agreement dated January 28, 1972, could not affect the assessability of the interest and lease rent incomes which had already accrued to the

assessee long before that date. In this view of the matter, the Tribunal reversed the order of the Appellate Assistant Commissioner in respect of the

inclusion of lease rent/interest in connection with plot H.

16. At the instance of the assessee, the Tribunal has referred the following two questions to us :

(1) Whether, on the facts and in the circumstances of the case and on a correct interpretation of the various deeds and documents referred to in

the Tribunal''s order, the income derived from the leasing out of plot H and the advancing of loans to Metropolitan Hotels Ltd. is assessable to tax

as a unit in the hands of the assessee as an association of persons and/or body of individuals ?

(2) Whether the Tribunal was correct in law in holding that it is only if the income is forgone before its accrual that such income could not come in

for taxation ?

17. Learned counsel for the assessee vehemently argued that since there were no distinguishing features between the leasing out of plots A to F

and plot H, the Tribunal was not justified in upholding the status of an association of persons adopted by the Income Tax Officer in respect of the

income arising out of plot H. According to him, the fact that these sixty-five persons had jointly taken loan from the First National City Bank would

not be of any help in determining as to under which status these persons should be assessed. In this connection, he invited our attention to the

earlier order of this Court in Income Tax Reference No. 231 of 1977 CIT v. Shivsagar Estates (AOP) [1993] 210 ITR 953 and strongly urged

that even in the case of plot H, the status should be of individuals and not of an association of persons.

18. As regards the income by way of lease rent and interest included in the total income of the assessee, the learned counsel for the assessee

submitted that by now the doctrine of real income has taken a firm footing and there are a number of decisions reported in the Income Tax Reports

wherein the courts have approved of this doctrine. In this connection, he submitted that if the income is not received or is not receivable by the

assessee due to certain circumstances beyond its control and there is a bilateral agreement between the assessee and the other party in respect of

waiver of such income, such income cannot be included in the total income of the assessee. In this connection, apart from relying on the aforesaid

two decisions, he relied on the decisions of the Supreme Court in the case of Commissioner of Income Tax, West Bengal II Vs. Birla Gwalior (P)

Ltd., , of the Punjab and Haryana High Court in the case of SHIV PARKASH JANAKRAJ and CO. (P.) LTD. Vs. COMMISSIONER OF

Income Tax, AMRITSAR-I., and of the Allahabad High Court in the cases of Motilal Padampat Sugar Mills Vs. Commissioner of Income Tax,

and Commissioner of Income Tax Vs. U.B.S. Publishers and Distributors, . Referring to some of the relevant portions of these judgments learned

counsel for the assessee pointed out that the fact that the waiver or giving up has taken place after the end of the year would not be of any

consequence as the real income could be determined either at the assessment stage or even at the appellate stage. He also pointed out that since

the assessee was not maintaining any books of account, there was no question of saying that the assessee was following the mercantile system of

accounting as was done by the Income Tax Officer or by the Tribunal. According to him, the Appellate Assistant Commissioner was fully justified

in holding that in the absence of any books of account maintained by the assessee, the income had to be assessed on the best judgment basis. In

the instance case, the income, even on the basis of best judgment, could not be estimated as the assessee and Messrs. Metropolitan Hotels Limited

had entered into an agreement dated January 28, 1972, whereby out of commercial expediency, the assessee agreed to give up its right to receive

lease rent/interest from the other party. In this connection, he also pointed out that substantial construction was carried out by Messrs.

Metropolitan Hotels Limited, including retention wall and, Messrs. Metropolitan Hotels Limited had spent over Rs. 51 lakhs in this direction.

Under the agreement dated January 28, 1972, the assessee had agreed to reimburse Messrs. Metropolitan Hotels Limited out of the money it

would receive from the other lessee, i.e., Messrs. Poonam Hotels Limited. In other words, he wanted to impress upon us that since the agreement

dated January 28, 1972, was a commercial agreement which any prudent businessman would have entered into, the Appellate Assistant

Commissioner was fully justified in holding that no income from plot H could be included in the total income of the assessee. According to him, the

Tribunal has failed to appreciate various decisions cited during the course of hearing, more particularly the decisions in which the waiver or giving

up of income had taken place after the end of the relevant accounting year. He, therefore, submitted that even if we answer question No. 1 against

the assessee, we must answer question No. 2 in favour of the assessee.

19. Learned counsel for the Revenue on the other hand submitted that since the taking of a huge loan from a bank and advancing the same to

Messrs. Metropolitan Hotels limited with a view to earn income from plot H was an integrated operation, the Income Tax Officer and the Tribunal

were fully justified in holding that so far as plot H was concerned, there was an association of person exploiting the plot in a commercial manner. In

this connection, he placed reliance on the decisions in the cases of Parvathi Devi and Others Vs. Commissioner of Income Tax, and Commissioner

of Income Tax Vs. Friends Enterprises, .

20. As regards the doctrine of real income, he relied on the decision of the Supreme Court in the case of Morvi Industries Ltd. Vs. Commissioner

of Income Tax (Central) Calcutta, , wherein according to him, the Supreme Court has indicated a different note than the one in the case of

Commissioner of Income Tax, Bombay City I Vs. Shoorji Vallabhdas and Co., . He also made a reference to the decision of the Supreme Court

in the case of the State Bank of Travancore Vs. Commissioner of Income Tax, Kerala, , wherein also the Supreme Court has discussed the theory

or doctrine of real income at page 155 of the Report.

21. We have considered the submissions of the parties and the material available on record and we entirely agree with the stand taken on behalf of

the Revenue that there is material a difference in the facts and circumstances obtaining in respect of plot H as compared to plots A to F, and,

therefore, the earlier decision of this Court in Income Tax Reference No. 231 of 1977 [Commissioner of Income Tax Vs. Shiv Sagar Estates

(Aop),] would not be applicable in toto to the facts obtaining in respect of plot H. In the said judgment, in paragraph 6, the High Court has

observed as under (at page 961) :

The Income Tax Act, 1961, clearly recognises dual capacity of a person or a group of person. In respect of the property in question, these

person were co-owners, in the company they were shareholders, in the partnership firm they were partners. They might also have formed an

association of person to carry on any other activity. All these can go on simultaneously. The very same person may receive income as co-owners

as shareholders, as partners or as members of an association of persons and their status in respect of a particular income will not affect their status

in respect of other income.

22. It would appear from the above that same person or persons can act or earn income in different capacities as individuals or as an association

of persons or as a shareholder or as a partner, etc. In respect of plot H, there is sufficient material on record to hold that apart from leasing out the

said plot to Messrs. Metropolitan Hotels Limited, there was a concerted plan to exploit the said plot commercially with a view to construct a hotel

of international standard. The sixty-five person jointly took a huge loan from the bank which was advanced to Messrs. Metropolitan Hotels

Limited on interest. Therefore, the income earned by way of lease rent and interest earned on the advances made to Messrs. Metropolitan Hotels

Limited have to be assessed differently. The former cannot be assessed in the status of association of person but has to be assessed in the

individual hands of the sixty-five person as per their respective shares. However, the interest earned on the loans advanced to Messrs.

Metropolitan Hotels Limited has to be assessed as the income of an association of person consisting of these sixty-five person.

23. As regards the taxability of the income arising from plot H by way of lease rent and interest on advances made to Messrs. Metropolitan Hotels

Limited is concerned, we are inclined to agree with the stand taken on behalf of the assessee that the doctrine of real income would be applicable

in the instant case. It is no doubt true that the assessee had given plot H to Messrs. Metropolitan Hotels Limited for constructing a hotel of

international standard in collaboration with Messrs. Hilton Hotels International. In fact, Messrs. Metropolitan Hotels Limited had started

construction, including that of construction of a retention wall, and spent more than Rs. 50 lakhs. However, the foreign collaborators, namely,

Messrs. Hilton Hotels International, expressed their doubt regarding the proposed hotel in view of foul smell coming out in the vicinity of plot H.

Under the circumstances, the said collaborators backed out from the project with the result that Messrs. Metropolitan Hotels Limited had to stop

further construction. Not only that, it was in such a bad financial state of affairs that it approached the assessee not to insist on receiving the lease

rent and the interest on the advances made to it. in Fact, Messrs. Metropolitan Hotels Limited was prepared to terminate the licence agreement

entered into between the assessee and itself and a was prepared to hand over plot H to the assessee with whatever construction was already made

thereon. Under these circumstances, the assessee and Messrs. Metropolitan Hotels Limited entered into an agreement dated January 28, 1972,

whereby the assessee waived the lease rent as well as the interest. In consideration thereof, the assessee got back plot H which it gave on lease to

another party. All these developments clearly show that the assessee had acted like a true prudent businessman to salvage the situation when

Messrs. Metropolitan Hotels Limited was not in a position to fulfil the agreement entered into earlier. We find from the paper book that the

assessee had reimbursed Messrs. Metropolitan Hotels Limited out of the money it received from the other party, i.e., Messrs. Poonam Hotels

Limited, to which the assessee had leased out plot H subsequently.

24. The doctrine of real income is a well-established doctrine and, therefore, it is not necessary to discuss all the reported cases on this issue. It

would suffice if a small portion of the decision of the Supreme Court in the case of Commissioner of Income Tax, Bombay City I Vs. Shoorji

Vallabhdas and Co., , is reproduced here (at page 148) :

income tax is a levy on income. No doubt, the Income Tax Act takes into account two points of time at which the liability to tax is attracted, viz.,

the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even

though in book keeping, an entry is made about a ''hypothetical income'', which does not materialise. Where income has, in fact, been received and

is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where,

however, the income can be said not to have resulted at all, there is obviously neither accrual not receipt of income, even though an entry to that

effect might, in certain circumstances, have been made in the books of account.

25. Learned counsel for the Revenue has cited the decision of the Supreme Court in the case of Morvi Industries Ltd. Vs. Commissioner of

Income Tax (Central) Calcutta, . However, it is pertinent to note that in the said decision the assessee had unilaterally given up the right to receive

income from the other party, which is not the case here. In our case as well as in the case of Commissioner of Income Tax, Bombay City I Vs.

Shoorji Vallabhdas and Co., , there was a bilateral agreement between the parties, that too, on commercial lines, to waive the receipt of the

income due to the fact that the other party was in a very bad financial state of affairs. According to us, the decision of the Supreme Court in the

case of State Bank of Travancore Vs. Commissioner of Income Tax, Kerala, , would not further the case of the Revenue, on the contrary, it would

support the stand takes on behalf of the assessee. in this connection, we would only refer to page 155 of the said decision where the Supreme

Court has summarised certain proposition, namely : (1) It is the income which was really accrued or arisen to the assessee that is taxable. Whether

the income has really accrued or arisen to the assessee must be judged in the light of the reality of the situation. (2) The concept of real income

would apply where there has been a surrender of income which in theory may have accrued but in the reality of the situation, no income had

resulted because the income did not really accrue. (3) The conduct of the parties in treating the income in a particular manner is material evidence

of the fact whether income had accrued or not. (4) Mere improbability or recover, where the conduct of the assessee is unequivocal, cannot be

treated as evidence of the fact that income has not resulted or accrued to the assessee. After debiting the debtor''s account and not reversing that

entry - but taking the interest merely in suspense account cannot be such evidence to show that no real income has accrued to the assessee or been

treated as such by the assessee. (5) The concept of real income is certainly applicable in judging whether there has been income or not but, in

every case, it must be applied with care and within well-recognised limits.

26. In the instant case, it is not in dispute that both the parties entered into an agreement in respect of waiver or giving up of income. In State Bank

of Travancore Vs. Commissioner of Income Tax, Kerala, , the bank had not reversed the entry but had taken the interest merely in suspense

account, In other words, it had not given up the hope of receiving the interest from the debtor. In the instant case, however, once the agreement

dated January 28, 1972, was entered into between the assessee and Messrs. Metropolitan Hotels Limited and once Messrs. Metropolitan Hotels

Limited has handed over plot H to the assessee, there was no question of any income arising therefrom which could be added in the total income

of the assessee.

27. In view of the aforesaid discussion, we answer the questions referred to us at the instance of the assessee as under :

Question No. 1 : The income from lease of plot H has to be assessed in the hands of each of the sixty-five co-owners as per their respective share

and not in the status of an association of persons. The income by way of interest of the loans advanced to Messrs. Metropolitan Hotels Limited is

to be assessed in the status of an association of person.

Question No. 2 : In the negative and in favour of the assessee.