

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD**INCOME TAX REFERENCE No. 5 of 2002****For Approval and Signature:**

HONOURABLE MR.JUSTICE AKIL KURESHI
HONOURABLE MS.JUSTICE HARSHA DEVANI

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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AMORA CHEMICALS (P) LTD. - Applicant(s)

Versus

C.I.T. - Respondent(s)

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Appearance :

MR RK PATEL for Applicant

MR KM PARIKH for Respondent

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CORAM : HONOURABLE MR.JUSTICE AKIL KURESHI

and

HONOURABLE MS.JUSTICE HARSHA DEVANI

Date : 28/08/2012

ORAL JUDGMENT

(Per : HONOURABLE MR.JUSTICE AKIL KURESHI)

1. In this reference, Income Tax Appellate Tribunal ("the Tribunal" for short) has referred the following questions of law for the opinion of the High Court.

"[1] Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that there was cost of acquisition of tenancy rights and that valuation of the said rights being determinable, the computation provisions under the Act are applicable and section 45 thereof would be attracted to the facts of the case?"

[2] Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the ratio of the Supreme Court decision in the case of A. R. Krishnamurti and another was applicable to the facts of the case of the applicant and that the ratio of the decision in the case of B.C. Srinivasa Setty was not at all applicable to the facts of the present case?"

[3] Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in equating the purchase of land, as in the case before the Supreme Court, with that of acquisition of tenancy rights as per Agreement dated 01.07.1978, and not appreciating that the rights under a purchase agreement could not be equivalent to the rights available under a lease agreement and that the ownership in the latter case was not full and absolute as in the case of the former transaction?"

[4] Whether, on the facts and in the circumstances of the case, the order of the Tribunal can be said to be correct in law and sustainable from the material on record it having failed to appreciate that the lease rent paid by the assessee was for the use of the premises in question and that advancing of loans at a chapter rate of interest did not amount to parting with the funds irrevocably, and as such neither the rent nor the loan could amount to consideration for the transfer of tenancy rights in question?"

[5] Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in not following

the binding decision of the Gujarat High Court in the case of Rajabeli Nazarali and Sons v. CIT which directly dealt with the controversy as to whether the amount of compensation received for parting with the capital asset i.e. tenancy rights could be termed as a revenue receipt liable to be taxed under any provisions of the Act?

[6] Whether, on the facts and in the circumstances of the case, the Tribunal after having referred to the Delhi High Court decision in the case of Bawa Shiv Charan Singh v. CIT regarding nature of tenancy rights and the varieties of elements which contributed to making the value of same, was it open to the Tribunal to state that the payment of lease rent and the advancing of loan would go to make the cost of tenancy rights for the purposes of computation of capital gains under section 45 of the Act?

[7] Whether, on the facts and in the circumstances of the case, the finding of the Tribunal is one which can be said to have been arrived at as a reasonable person after taking into consideration all relevant material and without being colored by any irrelevant consideration or matters of prejudice and basing its finding on suspicious, conjectures or surmises, or acting on improper rejection of material and relevant evidence or partly on evidence and partly on suspicious, conjectures or surmises?"

2. The above questions arise in the following factual background. The applicant – assessee is a Private Limited Company. It had entered into an agreement with one M/s L. M. Patel & B. M. Patel (H.U.F.) on 1st July 1978. Under such agreement, the HUF (hereinafter to be referred to as “the landlord”) agreed to give certain properties on rent to the assessee. The landlord was the owner of the rented property bearing census number 461/2/0, situated at Vadodara. Such land was partially developed and had a building having seven floors already constructed and further provision of three more floors which could be constructed thereupon.

2.1 The landlord agreed to rent out the second, fourth, fifth, sixth and seventh floors of the said building to the assessee for a monthly rent of Rs.9,970/-. The landlord also agreed to rent out eighth, ninth and tenth floors of the building as and when such construction was completed. Agreed rent for eighth and ninth floors was Rs.4,360/- per month and for the tenth floor, it was Rs.2,150/- per month.

2.2 The assessee in addition to agreeing to pay said monthly rent, also agreed to advance a sum of Rs.6 lakhs to the landlord on interest at the rate of 6% per annum.

2.3 It has come on record that though the assessee had agreed to advance a sum of Rs.6 lakhs to the landlord, since the landlord could not complete the construction of the remaining floors from such amount, the assessee gave further advance of Rs.2.50 lakhs at the same rate of interest to the landlord. It has also come on record that upon completion of the construction, the assessee sublet the properties to Bank of Baroda and had also taken a loan of Rs.8.50 lakhs at 15% interest per annum.

2.4 From the record, it emerges that such advance of Rs.8.50 lakhs was returned by the landlord after three years. In the meantime, the tenancy of the assessee continued. Nearly seven years after the date of the agreement, the assessee relinquished the tenancy rights for which it had received a sum of Rs.15 lakhs from the landlord. To relinquish the tenancy rights, the assessee company passed a resolution on 10.6.1984. Pursuant to such a resolution, the company relinquished tenancy rights in the year 1985, as against which

it received a sum of Rs.15 lakhs in the accounting year relevant to the assessment year 1986-87.

2.5 Before the Assessing Officer, the assessee contended that the sum of Rs.15 lakhs represented a capital receipt and therefore, was not liable to be taxed as income. It was further contended that the assessee also cannot be charged capital gain tax as there was no cost of acquisition of the tenancy rights in the hands of the assessee.

2.6 The Assessing Officer, however, was of the opinion that under the agreement dated 1.7.1978, the assessee had paid an advance of Rs.6 lakhs to the landlord on which it received interest at the rate of 6% per annum. Further adding Rs.10/- for the stamp paper on which the agreement was executed, the Assessing Officer treated a sum of Rs.6,00,010/- as the cost of acquisition of tenancy rights. The difference i.e. Rs.8,99,990/- (Rs.15,00,000 – Rs.6,00,010), according to the Assessing Officer, represented long term capital gain of the assessee to be taxed at an appropriate rate.

2.7 The assessee approached the Commissioner against such decision of the Assessing Officer. The Commissioner noted that total amount advanced by the assessee to the landlord was not Rs.6 lakhs, but Rs.8.50 lakhs. Such amount was borrowed by the assessee from the bank against overdraft facility and paid interest at the rate of 15% p.a. on such borrowing. Since the assessee received only 6% interest from the landlord, the CIT (Appeals) was of the opinion that the difference of interest for a period of three years till the sum advanced remained with the landlord, would represent the cost of acquisition of the tenancy

rights to the assessee. He was, therefore, of the opinion that interest difference of 9% p.a. on the sum advanced i.e. Rs.8.50 lakhs for a period of three years should represent the cost of acquisition of the tenancy rights. He, accordingly, remanded the matter back to the Assessing Officer to recompute the cost of acquisition in above terms.

2.8 The assessee went further in appeal before the Tribunal. Before the Tribunal, it was contended that there was no cost of acquisition of the tenancy rights of the assessee and that therefore, the assessee was not chargeable to capital gains. The Tribunal, however, upheld the decision of the CIT (Appeals) primarily placing reliance on the decision of the Apex Court in case of **A. R. Krishnamurthy and another v. Commissioner of Income Tax, Madras**, reported in (1989) 176 ITR 417. Against such decision, the assessee sought a reference to the High Court. Initially, the Tribunal declined to make a reference. Ultimately, under an order dated 03.08.2000 passed by the Apex Court, such reference was directed to be made. While doing so, the Supreme Court also observed that it will be open to the High Court to concise the seven questions into one or two.

3. Having, thus, heard the learned counsel for the parties, we find that reference to all seven questions would not be necessary and would only be a duplication of various facets of the same controversy. We, therefore, re-frame the question for our consideration as under :

“Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the

differential interest borne by the assessee on the advances made to the landlord represented the cost of acquisition of the tenancy rights to the assessee and accordingly, the revenue could collect long term capital gain on the difference of the amount received by the assessee on surrendering the tenancy rights and the cost of acquisition of such tenancy?"

4. Learned counsel Shri R. K. Patel for the petitioner, drawing our attention to the statutory provisions applicable, as they stood at the relevant time, submitted that in case of acquisition of tenancy rights, unless the costs thereof can be ascertained, there would be no question of charging capital gain. He submitted that in the present case, the assessee had made advances to the landlord. Even if such advances were made at an interest rate lower than what the assessee had paid to the bank for borrowing such amount, the difference in the interest rate would not represent the cost of acquisition of the tenancy rights.

4.1 Counsel submitted that there is nothing in the agreement to suggest that the advance was made at a reduced rate of interest in lieu of the landlord putting the assessee in possession as a tenant.

4.2 Counsel submitted that section 55(2) of the Income Tax Act, 1961 ("the Act" for short) was amended with effect from 1.4.1995 to include the transfer of tenancy rights besides others for the deeming fiction of ascertaining the cost of acquisition when such costs were otherwise not ascertainable. It was submitted that such amendment is not retrospective and

therefore, cannot be applied to the present case which concerns the assessment year 1986-87.

4.3 Counsel drew our attention to several decisions in support of his contentions as under :

[a] In case of **Commissioner of Income Tax, Bangalore v. B. C. Srinivasa Setty**, reported in (1981) 128 ITR 294 wherein the Apex Court in the context of transfer of a goodwill by the assessee, observed that the goodwill cannot be described as an asset. It was further held that all transactions encompassed by section 45 must fall under the governance of its computation provisions. A transaction to which those provisions cannot be applied must be regarded as never intended by section 45 to be the subject of the charge. What is contemplated by section 48(ii) is an asset in the acquisition of which it is possible to envisage a cost.

[b] In case of **Commissioner of Income Tax v. Manoharsinhji P. Jadeja**, reported in (2006) 281 ITR 19, the Division Bench of this Court finding that certain properties were inherited by the assessee were acquired through conquest, held that it was not possible to envisage a cost of acquisition of such a property. Relying on the decision of the Apex Court in case of **B. C. Srinivasa Setty** (supra), the Division Bench held that the assessee was not liable to pay capital gain tax on sale of such property.

[c] Our attention was drawn to the decision of the Supreme Court in case of **A. R. Krishnamurthy and another v. Commissioner of Income Tax, Madras**, reported in (1989)

176 ITR 417, to contend that the facts of the present case are different and the ratio of the decision would not apply since in the said case, the Court found that the cost of acquisition of the tenancy rights was ascertainable.

[d] In case of **Commissioner of Income Tax v. D. P. Sandu Bros. Chembur P. Ltd.**, reported in (2005) 273 ITR 1, wherein the Apex Court finding that if it is not possible to recompute the cost of acquisition of the tenancy rights, there would be no question of charging transfer of capital gain on such assets.

[e] Reference was made to the decision of the Apex Court in case of **Guffic Chem P. Ltd. v. Commissioner of Income Tax**, reported in (2011) 332 ITR 602 wherein the question involved was of taxing receipt of an assessee on non-competition agreement. The Apex Court held that it was only vide Finance Act, 2002 with effect from 1.4.2003 that such receipt was made taxable. Till then, such compensation received by the assessee under non-competition agreement was a capital receipt not chargeable to tax under Income Tax Act, 1961. This decision was cited to contend that amendment in section 55(2) with effect from 1.4.1995 is only prospective in nature.

5. On the other hand, learned counsel Shri Parikh for the Department opposed the appeal. He submitted that the assessee had made advances at reduced rate of interest. Such funds were raised through borrowings from the bank on which the assessee had paid much higher interest. Differential rate of interest should, therefore, be regarded as the assessee's cost of acquisition of the tenancy rights.

6. Before dealing with the rival contentions, we may peruse the applicable statutory provisions obtaining at the relevant time. Section 2(14) of the Act defined the term “capital asset” as to mean property of any kind held by an assessee, whether or not connected with his business or profession, excluding certain specified properties with which we are not concerned.

6.1 Section 2(47) contained definition of “transfer” which read as under :

“2(47) “Transfer” in relation to a capital asset, includes -

- (i) the sale, exchange or relinquishment of the asset;*
or
- (ii) the extinguishment of any rights therein; or*
- (iii) the compulsory acquisition thereof under any law;*
or
- (iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment; or*
- (v) the maturity or redemption of a zero coupon bond;*
or
- (vi) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882); or*
- (vii) any transaction (whether by way of becoming a member of, or acquiring shares in, a cooperative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property:”*

6.2 Section 45, the charging section for capital gains, reads

as under :

"Section 45. CAPITAL GAINS.

(1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 54, 54B, 54D, 54E, 54EA, 54EB, 54F , 54G and 54H 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.

(1A) Notwithstanding anything contained in sub-section (1), where any person receives at any time during any previous year any money or other assets under an insurance from an insurer on account of damage to, or destruction of, any capital asset, as a result of - (i) Flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or

(ii) Riot or civil disturbance; or

(iii) Accidental fire or explosion; or

(iv) Action by an enemy or action taken in combating an enemy (whether with or without a declaration of war), then, any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head "Capital gains" and shall be deemed to be the income of such person of the previous year in which such money or other asset was received and for the purposes of section 48, value of any money or the fair market value of other assets on the date of such receipt shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital asset.

Explanation. - For the purposes of this sub-section, the expression "insurer" shall have the meaning assigned to it in clause (9) of section 2 of the Insurance Act, 1938 (4

of 1938).

(2) Notwithstanding anything contained in sub-section (1), the profits or gains arising from the transfer by way of conversion by the owner of a capital asset into, or its treatment by him as, stock-in-trade of a business carried on by him shall be chargeable to income-tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him and, for the purposes of section 48, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.

(2A) Where any person has had at any time during previous year any beneficial interest in any securities, then, any profits or gains arising from transfer made by the depository or participant of such beneficial interest in respect of securities shall be chargeable to income-tax as the income of the beneficial owner of the previous year in which such transfer took place and shall not be regarded as income of the depository who is deemed to be registered owner of securities by virtue of sub-section (1) of section 10 of the Depositories Act, 1996, and for the purposes of - (i) Section 48; and

(ii) Proviso to clause (42A) of section 2, the cost of acquisition and the period of holding of any securities shall be determined on the basis of the first-in-first-out method.

Explanation. - For the purposes of this sub-section, the expressions "beneficial owner", "depository" any "security" shall have the meanings respectively assigned to them in clauses (a), (e) and (l) of sub-section (1) of section 2 of the Depositories Act, 1996.

(3) The profits or gains arising from the transfer of a capital asset by a person to a firm or other association of persons or body of individuals (not being a company or a co-operative society) in which he is or becomes a partner or member, by way of capital contribution or otherwise,

shall be chargeable to tax as his income of the previous year in which such transfer takes place and, for the purposes of section 48, the amount recorded in the books of account of the firm, association or body as the value of the capital asset shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.

(4) The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or a co-operative society) or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place and, for the purposes of section 48, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of the consideration received or accruing as a result of the transfer.

(5) Notwithstanding anything contained in sub-section (1), where the capital gain arises from the transfer of a capital asset, being a transfer by way of compulsory acquisition under any law, or a transfer the consideration for which was determined or approved by the Central Government or the Reserve Bank of India, and the compensation or the consideration for such transfer is enhanced or further enhanced by any court, Tribunal or other authority, the capital gain shall be dealt with in the following manner, namely :- (a) The capital gain computed with reference to the compensation awarded in the first instance or, as the case may be, the consideration determined or approved in the first instance by the Central Government or the Reserve Bank of India shall be chargeable as income under the head "Capital gains" of the previous year in which such compensation or part thereof, or such consideration or part thereof, was first received; and

(b) The amount by which the compensation or consideration is enhanced or further enhanced by the court, tribunal or other authority shall be deemed to be income chargeable under the head "Capital gains" of the

previous year in which such amount is received by the assessee.

Explanation : For the purposes of this sub-section, - (i) In relation to the amount referred to in clause (b), the cost of acquisition and the cost of improvement shall be taken to be nil;

(ii) The provisions of this sub-section shall apply also in a case where the transfer took place prior to the 1st day of April, 1988;

(iii) Where by reason of the death of the person who made the transfer, or for any other reason, the enhanced compensation or consideration is received by any other person, the amount referred to in clause (b) shall be deemed to be the income chargeable to tax under the head "Capital gains", of such other person.

(6) Notwithstanding anything contained in sub-section (1), the difference between the repurchase price of the units referred to in sub-section (2) of section 80CCB and the capital value of such units shall be deemed to be the capital gains arising to the assessee in the previous year in which such repurchase takes place or the plan referred to in that section is terminated and shall be taxed accordingly.

Explanation : For the purposes of this sub-section, "capital value of such units" means any amount invested by the assessee in the units referred to in sub-section (2) of section 80CCB."

6.3 Section 48 provided the mode of computation and deductions for the purpose of capital gain and read as under :

"Section 48. MODE OF COMPUTATION.

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 asset and the cost of any improvement thereto :

Provided that in the case of an assessee, who is a non-resident, capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as was initially utilized in the purchase of the shares or debentures, and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so however, that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every reinvestment thereafter in, and sale of, shares in, or debentures of, an Indian company :

Provided further that where long-term capital gain arises from the transfer of a long-term capital asset, other than capital gain arising to a non-resident from the transfer of shares in, or debentures of, an Indian company referred to in the first proviso, the provisions of clause (ii) shall have effect as if for the words "cost of acquisition" and "cost of any improvement", the words "indexed cost of acquisition" and "indexed cost of any improvement" had respectively been substituted.

Provided also that nothing contained in the second proviso shall apply to the long-term capital gain arising from the transfer of a long-term capital asset being bond or debenture other than capital indexed bonds issued by the Government.

Explanation : For the purposes of this section, - (i) "Foreign currency" and "Indian currency" shall have the meanings respectively assigned to them in section 2 of the Foreign Exchange Regulation Act, 1973 (46 of 1973);

(ii) The conversion of Indian currency into foreign currency and the reconversion of foreign currency into Indian currency shall be at the rate of exchange prescribed in this behalf;

(iii) "Indexed cost of acquisition" means an amount which bears to the cost of acquisition the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 1st day of April, 1981, whichever is later;

(iv) "Indexed cost of any improvement" means an amount which bears to the cost of improvement the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset took place;

(v) "Cost Inflation Index" for any year means such Index as the Central Government may, having regard to seventy-five per cent of average rise in the Consumer Price Index for urban non-manual employees for that year, by notification in the Official Gazette, specify 759 in this behalf. "

6.4 Section 55 provided the meaning of terms "adjusted", "cost of improvement" and "cost of acquisition". Sub-section (2) of section 55 of the Act provided the manner in which the cost of acquisition for the purpose of sections 48 and 49 of the Act would be worked out, relevant portion of which read as under :

“[2] For the purposes of sections 48 and 49, “cost of acquisition”, in relation to a capital asset, -

[i] where the capital asset became the property of the assessee before 1st day of January, 1964, means the cost of acquisition of the asset to the assessee or the fair market value of the asset on the 1st day of January, 1964, at the option of the assessee;

[ii] where the capital asset became the property of the assessee by any of the modes specified in sub-section (1) of section 49, and the capital asset became the property of the previous owner before the 1st day of January, 1964, means the cost of the capital asset to the previous owner or the fair market value of the asset on the 1st day of January, 1964, at the option of the assessee;”

6.5 At this stage, we may also notice that with effect from 1.4.1995, section 55 of the Act and in particular, sub-section (2) thereof, came to be amended. In the amended form, relevant portion of section 55(2) reads as under :

“(2) For the purposes of sections 48 and 49, “cost of acquisition”, - (a) In relation to a capital asset, being goodwill of a business, or a right to manufacture, produce or process any article or thing, tenancy rights, stage carriage permits or loom hours, -

(i) In the case of acquisition of such asset by the assessee by purchase from a previous owner, means the amount of the purchase price; and

(ii) In any other case [not being a case falling under sub-clauses (i) to (iv) of sub-section (1) of section 49], shall be taken to be nil;”

7. The fact that the tenancy right represented capital asset in the hands of the assessee, there is no dispute. In terms of

section 2(14) of the Act, it is clear that such tenancy rights represented capital assets. Further, that by virtue of section 2(47) of the Act which provides for a definition of the term “tenancy” for the purpose of income-tax, surrender of such tenancy rights amounted to transfer of the capital assets, is also not disputed. So much is also clearly held by the Apex Court in the case of **Sandu Bros. Chembur P. Ltd.** (supra), wherein it was observed as under :

“That the tenancy right is a capital asset, the surrender of the tenancy right is a “transfer” and the consideration received therefore a capital receipt within the meaning of Section 45 has not been questioned before us and must in any event be taken to be concluded by the decision of this Court in A. Gasper v. Commissioner of Income Tax. Normally the consideration would therefore be subjected to capital gains under Section 45.”

8. The question, however, is whether there was a cost of acquisition of such tenancy rights which can be ascertained and that therefore, the capital gain in the hands of the assessee can be computed. This question arises in view of the three decisions of the Apex Court cited before us. In case of **B. C. Srinivasa Setty** (supra), the Apex Court finding that the cost of acquisition of a goodwill of a business is not ascertainable, proceeded to hold that when computation of charging capital gain fails, it can be held that the legislature never intended to tax such transfers to capital gain.

8.1 After the decision in case of **B. C. Srinivasa Setty** (supra), the Apex Court delivered judgement in case of **A. R. Krishnamurthy and another** (supra) which involved the question of capital gain on receipt upon surrendering of a

mining lease. The assessee purchased certain pieces of land on which a mining lease was granted to a private company to extract clay for a period of 10 years at a premium of Rs.5 lakhs in addition to payment of royalty. In that case, the Apex Court held that the cost of acquisition of the land would include the “cost of acquisition” of the mining right under the lease and the date of acquisition of the right to grant lease had to be the same as the date of acquisition of the freehold rights. The amount paid by the assessee to purchase the land was for acquiring a bundle of rights in the land including the right to grant a lease. The cost of acquisition had to be apportioned in each case on the basis of evidence.

8.2 Subsequent to the decision in case of **A. R. Krishnamurthy and another** (supra), the Apex Court delivered yet another judgement in case of **Sandu Bros. Chembur P. Ltd.** (supra). Such decision was concerning the question of charging capital gain on surrender of tenancy rights. In the said case, the Department had contended that the assessee on surrender of tenancy, had received such amount which was chargeable as capital gain under section 45 of the Act. It was contended that an asset which is capable of acquisition at a cost would be subject to capital gains as opposed to the assets in the acquisition of which no cost at all can be conceived as in the case of goodwill as held by the Apex Court in case of **B. C. Srinivasa Setty** (supra).

9. The Supreme Court referring to the decision in case of **A. R. Krishnamurthy and another** (supra), observed that in a given case, it is possible that tenancy right may be acquired at a cost. Ultimately, it would be a question of fact. The Apex

Court further observed that but for the inability to compute cost of acquisition under section 48, a monthly tenancy or leasehold right is a capital asset and that the amount of receipt on its surrender was a capital receipt. In the facts of the case, the Apex Court found that capital gain could not be charged since it was not possible to compute the cost of acquisition of the tenancy rights. Observations of the Supreme Court relevant for our purpose, read as under :

"12. We agree. A tenancy right is acquired with reference to a particular date. It is also possible that it may be acquired at a cost. It is ultimately a question of fact. In A.R. Krishnamurthy and Ors. v. Commissioner of Income Tax, Madras (1989) 176 ITR 417 this Court held that it cannot be said conceptually that there is no cost of acquisition of the grant of the lease. It held that the cost of acquisition of leasehold rights can be determined. In the present case however, the Department's stand before the High Court was that the cost of acquisition of the tenancy was incapable of being ascertained. In view of the stand taken by the Department before the High Court, we uphold the decision of the High Court on this issue.

13. Were it not for the inability to compute the cost of acquisition under Section 48, there is, as we have said, no doubt that a monthly tenancy or leasehold right is a capital asset and that the amount receipt on its surrender was a capital receipt. But because we have held that Section 45 cannot be applied, it is not open to the Department to impose tax on such capital receipt by the assessee under any other Section. This Court, as early as in 1957 had, in United Commercial Bank Ltd. V. Commissioner of Income Tax Ltd., West Bengal (1957) 32 ITR 688, held that the heads of income provided for in the Sections of the Income Tax Act, 1922 are mutually exclusive and where any item of income falls specifically under one head, it has to be charged under that head and no other. In other words, income derived from different sources falling under a specific head has to be computed for the purposes of taxation in the manner

provided by the appropriate Section and no other. It has been further held by this Court in East India Housing and Land Development Trust Ltd. V. Commissioner of Income Tax, West Bengal (1961) 42 ITR 49 that if the income from a source falls within a specific head, the fact that it may indirectly be covered by an another head will not make the income taxable under the latter head. (See also: Commissioner of Income Tax Vs. Chugandas and Co. (1964) 55 ITR 17).

16. There is no dispute that a tenancy right is a capital asset the surrender of which would attract Section 45 so that the value received would be a capital receipt and assessable if at all only under Item E of Section 14. That being so, it cannot be treated as a casual or non recurring receipt under Section 10(3) and be subjected to tax under Section 56. The argument of the appellant that even if the income cannot be chargeable under Section 45, because of the inapplicability of the computation provided under Section 48, it could still impose tax under the residuary head is thus unacceptable. If the income cannot be taxed under Section 45, it cannot be taxed at all. (See: S.G. Mercantile Corporation (P) Ltd. Vs. Commissioner of Income Tax, Calcutta (1972) 83 ITR 700)."

10. What emerges from the above three decisions of the Supreme Court is that as per the statutory provisions applicable at the relevant time, the capital asset in case of which it is not possible to conceive or ascertain the cost of acquisition, there would be no charge of capital gain. In case of tenancy rights, however, depending on facts of case, it has to be ascertained whether the cost of acquisition of tenancy right was possible to ascertain. Acquisition of tenancy right did not fall in the same category as the acquisition of goodwill of a business in which the cost of acquisition was not conceivable. Before going further, however, we may recall that section 55(2) of the Act came to be substantially amended with effect from 1.4.1995. The legislature has since then provided for the

deeming fiction under which cost of acquisition of tenancy rights besides others specified capital assets could be worked out. It is not in dispute that such provision had no retrospective application. It was not even seriously argued before us by the revenue that such amended provision could be made applicable to the case on hand.

11. In the background of above legal position, we have to ascertain from the facts on record whether it is possible to ascertain the cost of acquisition of the tenancy rights. We may recall that the assessee and the landlord entered into an agreement under which, the landlord agreed to rent out four existing floors to the assessee, and for three more under construction floors of the building, the assessee agreed to advance to the landlord a sum of Rs.6 lakhs on which the landlord would pay interest at the rate of 6% p.a. Both sides agreed to certain fixed monthly rent on such rental properties. The agreement did not provide for either termination of the tenancy rights or the period during which such advance made to the landlord would be returned to the assessee. In other words, the tenancy did not have a fixed life. The period for which such advance would be made to the landlord was also not specified. From the record, it further emerges that such advance was made for the purpose of completing the remaining construction. Since the landlord could not complete the construction with the agreed amount, the assessee made further advance of Rs.2.50 lakhs at same interest rate. It has also come on record that the landlord returned the amount after a period of three years though the tenancy continued for several years thereafter.

12. We are of the opinion that the entire contract was a composite agreement of advancement of loan at a reduced interest, granting property on rent to the assessee and the fixation of the rent also. It is impossible to distinguish any part of the differential interest which can be attributed to the cost of acquisition of the tenancy rights. As noted, the agreement is a composite agreement under which, besides other terms and conditions, the landlord and tenant agreed that the property would be rented out at a certain monthly rental. It is not possible to segregate a portion of the advance going towards the cost of acquisition of the tenancy rights and a portion going towards reduced rent, if any.

13. One significant feature is that there was no fixed period for holding such advance by the landlord. Against the tenancy which continued nearly for a period of seven years, the advances were held by the landlord for only three years. The cost of acquisition of property is a payment made or deferred by the purchaser at the time of acquiring such property. Such price cannot be a fluctuating price depending on the period for which the advance is made or held by the landlord. In the present case, the landlord held the advances for a period of three years. The agreement did not provide for such a period. If the advance was not returned for a period of four, five or six years, the cost of acquisition would defer. This is an additional ground to convince us that such differential rate in interest on the advance made, cannot be seen as a cost of acquisition of the property or at any rate, being inapportionable proportion.

14. In the result, we are of the opinion that in view of the decision of the Apex Court in case of **Sandu Bros. Chembur**

P. Ltd. (supra), the Tribunal committed an error in confirming the view of the Commissioner (Appeals). We answer the question in the negative i.e. in favour of the appellant – assessee and against the revenue. The matter shall be placed before the Tribunal for further consequential steps. We dispose of the reference with above opinion.

[AKIL KURESHI, J.]

[HARSHA DEVANI, J.]

parmar*

