

COMMISSIONER OF INCOME TAX, HYDERABAD

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v.

M/S. MOTOR AND GENERAL STORES (P.) LTD.

May 2, 1967

[J. C. SHAH, S. M. SIKRI AND V. RAMASWAMI, JJ.]

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Income-tax Act, 1922 s. 10(2) (vii)—Assessee selling 'cinema' and other assets in exchange for shares in another Company—Whether transaction one of 'sale' or 'exchange'—Therefore whether difference between book-value of assets and exchange consideration taxable—Determining the substance rather than form of transaction in revenue matters—Conditions for.

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The respondent private Limited Company owned a cinema house and at a meeting of its Board of Directors on September 9, 1955, it was resolved that the Managing Director may be authorised to negotiate with a buyer for the sale of the entire concern with all its equipment and machinery etc. for a consideration of Rs. 1,20,000. After an agreement had been concluded to effect a sale and had been confirmed at an extraordinary general meeting of the company on October 4, 1955, an "exchange deed" was entered into on February 21, 1956 and the consideration was received by the assessee company in the shape of transfer of certain shares of the face value of Rs. 1,20,000 owned by the buyer in another company.

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In the course of its assessment to tax for the year 1956-57, the Income-tax Officer computed the respondent's profits under s. 10(2)(vii) by including an amount of Rs. 43,568 on account of the excess amount realised over the written down value of the assets sold. The order of the Income-tax Officer was confirmed, in appeal, by the Appellate Assistant Commissioner and substantially also by the Tribunal. However, upon a reference under s. 66(2) of the Act the High Court answered the question in favour of the respondent.

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In the appeal to this Court it was contended on behalf of the appellant that the money consideration for the assets was fixed at Rs. 1,20,000 and the mode of payment was by transfer of shares so that the transaction was really a sale and not transfer by way of exchange; that the resolution of the Board of Directors and of the shareholders reproduced in the preamble of the exchange deed showed clearly that what was authorised was the sale of the entire concern; and that in revenue matters it was the substance of the transaction which must be looked at and not the form in which the parties have chosen to clothe the transaction.

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HELD : The Income-tax authorities were not entitled to treat the transaction as a sale and to apply the provisions of s. 10(2)(vii) of the Income-tax Act, 1922. In essence the transaction was one of exchange and there was no sale of the properties described in the exchange deed. There was no price paid or promised to be paid for the transfer of the properties but there was only a consideration in the shape of transfer of shares in another company by the buyer. [883E-G]

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It was clear from the operative part of the exchange deed that there was an exchange of the properties described in it for the shares of a

A company. Neither the recital in the preamble nor the resolutions could control the language of the operative portion of the deed or its legal effect. [883D-E]

Madam Pillai v. Badrakali Ammal, I.L.R. 45 Madras 612, referred to.

B The contention that in the present case it was the substance rather than the form of the transaction which should be looked at must be rejected. There was no suggestion on behalf of the appellant of bad faith nor was it alleged that the particular form of the transaction was adopted as a cloak to conceal a different transaction. In the absence of any such suggestion the true principle is that the taxing statute has to be applied in accordance with the legal rights of the parties to the transaction. When the transaction is embodied in a document, the liability to tax depends upon the meaning and content of the language used in accordance with the ordinary rules of construction. [883H; 884B]

Bank of Chettinad Ltd. v. C.I.T. Madras, 1940 I.T.R. 522; *Duke of Westminster's case*, 19 T.C. 490; and *Commissioner of Inland Revenue v. Wesleyan and General Assurance Society*, 30 T.C. 11, referred to.

C CIVIL APPELLATE JURISDICTION : Civil Appeal No. 819 of 1966.

D Appeal by special leave from the judgment and order dated October 30, 1964 of the Andhra Pradesh High Court in case Referred No. 6 of 1963.

E *D. Narsaraju, T. A. Ramachandran and R. N. Sachthey* for the appellant.

P. Ram Reddy and A. V. V. Nair, for the respondent.

The Judgment of the Court was delivered by

F **Ramaswami, J.** This appeal is brought, by special leave, on behalf of the Commissioner of Income-tax, Hyderabad from the judgment of the Andhra Pradesh High Court dated October 30, 1964 in a case Referred No. 6 of 1963.

G The respondent (hereinafter referred to as the ('assessee-company') is a private limited company owning a cinema house called "Sree Rama Talkies", at Bobbili. It was being taxed on the profits made by exhibition of films therein. At a meeting of its Board of Directors held on September 9, 1955, it was resolved that the Managing Director, the Raja of Bobbili may be authorised to negotiate with the Zamindar of Chikkavaram or his nominee for the sale of the entire concern with all its equipment and machinery, fittings etc. for a consideration of Rs. 1,20,000/-. An agreement was concluded to effect a sale and this was confirmed by the assessee-company at an extra-ordinary general body meeting held on October 4, 1955. Pursuant thereto a deed called the "exchange deed" was brought into existence on February 21, 1956 and the consideration was received by the assessee-

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company in the shape of transfer of 5% tax-free cumulative preference shares in Sri Rania Sugar and Industries Ltd., Bobbili, of the face value of Rs. 1,20,000/- held by the Zamindar and Zamindarini of Chikkavaram. Separate valuation was given for the immovable property and for the movables etc. and goodwill, each being valued at Rs. 60,000/-. For the assessment year 1956-57, the assessee-company submitted a return of income showing a sum of Rs. 9,823/- as profits derived from the transaction. The Income-tax Officer found that the value realised exceeded the written down value by Rs. 43,568/- and accordingly computed the profits under s. 10(2)(vii) of the Income-tax Act, 1922 and included the amount in the taxable income of the assessee-company. The order of the Income-tax Officer was confirmed by the Appellate Assistant Commissioner in appeal and by the Income-tax Appellate Tribunal except for allowing a sum of Rs. 5,000/- as representing the cost of the goodwill. As directed by the High Court, the Appellate Tribunal stated a case under s. 66(2) of the Income-tax Act, 1922 on the following question of law :

"(1) Whether the transaction dated 21-2-1956 amounts to a sale within the purview of the second proviso to section 10(2) (vii) of the Indian Income-tax Act; alternatively,

(2) Whether the consideration for the sale is not the market value of the shares as on the date of the transaction, namely, Rs. 95/- per share, but the face value of the shares."

After hearing the reference the High Court answered the question in favour of the assessee-company and against the Commissioner of Income-tax.

Section 10(2)(vii) of the Income-tax Act, 1922 provides as follows :

"10. Business. (2) Such profits or gains shall be computed after making the following allowances, namely :—

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(vii) in respect of any such building, machinery or plant which has been sold or discarded or demolished or destroyed, the amount by which the written down value thereof exceeds the amount for which the building, machinery or plant, as the case may be, is actually sold or its scrap value :

Provided that such amount is actually written off in the books of the assessee :

A Provided further that where the amount for which any such building, machinery or plant is sold, whether during the continuance of the business or after the cessation thereof, exceeds the written down value, so much of the excess as does not exceed the difference between the original cost and the written down value shall be deemed to be profits of the previous year in which the sale took place:

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.....”
It is only if there is a sale of the cinema house and the other assets that the taxable profits and gains are to be computed in the present case under s. 10(2)(vii) as the amount by which the written down value exceeds the amount for which the assets are actually sold. The words “sale” or “sold” have not been defined in the Income-tax Act, 1922. Consequently, these words have to be construed by reference to other enactments. Section 54 of the Transfer of Property Act defines ‘sale’ as a transfer of ownership in exchange for a price paid or promised or part paid and part promised. Section 54 of the Transfer of Property Act reads as follows:

“Sale’ is a transfer of ownership in exchange for a price paid or promised or part-paid and part-promised.”

E There is no definition of the word ‘price’ in this Act. But it is well-settled that the word ‘price’ is used in the same sense in this section as in s. 4 of the Sale of Goods Act, 1930 (Act III of 1930) (See the decision of a Full Bench of the Madras High Court in *Madam Pillai v. Badrakali Ammal*)⁽¹⁾. Section 4 of the Sale of Goods Act reads as follows :

F “(1) A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. There may be a contract of sale between one part-owner and another.

(?) A contract of sale may be absolute or conditional.

G (3) Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.

H (4) An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.”

(1) I.L.R. 45. Madras, 612.

Section 2(10) of the Sale of Goods Act defines "price" as meaning the money consideration for a sale of goods. The presence of money consideration is therefore an essential element in a transaction of sale. If the consideration is not money but some other valuable consideration it may be an exchange or barter but not a sale. Section 118 of the Transfer of Property Act defines 'exchange' as follows:

"When two persons mutually transfer the ownership of one thing for the ownership of another, neither thing, or both things being money only, the transaction is called an 'exchange'.

A transfer of property in completion of an exchange can be made only in manner provided for the transfer of such property by sale."

Section 119 provides :

"If any party to an exchange or any person claiming through or under such party is by reason of any defect in the title of the other party deprived of the thing or any part of the thing received by him in exchange, then, unless a contrary intention appears from the terms of the exchange, such other party is liable to him or any person claiming through or under him for loss caused thereby, or at the option of the person so deprived, for the return of the thing transferred, if still in the possession of such other party or his legal representative or a transferee from him without consideration."

The definition of exchange in s. 118 of the Transfer of Property Act is not limited to immovable property but it extends also to barter of goods. It is clear therefore that both under the Sale of Goods Act and the Transfer of Property Act, sale is a transfer of property in the goods or of the ownership in immovable property for a money consideration. But in exchange there is a reciprocal transfer of interest in the immovable property, the corresponding transfer of interest in the movable property being denoted by the word 'barter'. "The difference between a sale and an exchange is this, that in the former the price is paid in money, whilst in the latter it is paid in goods by way of barter." (Chitty on Contracts 22nd Edn., Vol. II page 582).

The question presented for determination in this case is whether the transaction of February 21, 1956 was a sale and whether the Income-tax authorities were entitled to include the amount of Rs. 43,568/- as profits under s. 10(2)(vii) of the Income-tax Act as representing the excess of the consideration

- A realised by the assessee-company over the written down value of the assets transferred. On behalf of the appellant it was contended that the money consideration was fixed at Rs. 1,20,000/- and the mode of payment was by transfer of shares and the transaction was really a sale and not transfer by way of exchange. We are unable to accept this argument as correct. In the first place, the document is called "exchange deed". The preamble of the document states :

C "And whereas the party of the first part as at the Directors meeting held on 3-2-1955 resolved to exchange the property mentioned in Schedule for the property mentioned in Schedule II belonging to the party of the second part and whereas in pursuance of the resolution of the Board of Directors the Managing Director of the party of the first part had handed over possession of the property described in Schedule I hereto on 9-9-1955 to the party of the second part and whereas the general body of the first part at a meeting held on D 4-10-1955 resolved to authorise the Managing Director of the party of the first part to negotiate with the zamindar and zamindarini of Chikkavaram the second part herein and or their nominees for the sale of the party of the entire concern known by the name of Sri Rama Talkies, Bobbili now owned by the party of the first part, E with all its equipment machinery fittings spares accessories the old Projector the Jeej car bearing No. M.S.P. 928 purchased from its funds all the buildings and out houses either newly constructed or mentioned in the registered sale deed No. 1464/5-9-1949 and in this exchange deed together with entire premises covered F thereby and the cash deposits lying with the various distributors and commercial tax department of the State Government more fully described in Schedule I hereto and also the goodwill of the concern for a consideration of Rs. 1,20,000/- (Rupees one lakh twenty thousand only) consisting of immovable properties worth Rs. 60,000/- and movable properties worth G Rs. 20,000/- (*sic*) total Rs. 1,20,000 which will be received in the shape of transfer of 5% tax-free cumulative preference shares of Messrs Sri Rama Sugars & Industries Ltd., Bobbili of the face value of Rs. 1,20,000/- (rupees one lakh twenty thousand only) H the party of the second part herein and more fully described in Schedule II herein and to transfer receipt and also hand over records relating to the title and management to enable them to carry on the business of the

concern and whereas the general body of the part of the first part at the meeting held on 11-2-1956 resolved that the action of the managing director in handing over possession of the property described in Schedule I to the party of the second part on 9-9-1955 is approved and whereas the parties hereto have agreed to exchange the said properties described in the first and second Schedule hereto in the manner hereinafter appearing."

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The operative part of the document reads as follows :

"Now this deed witnesseth as follows :

- (1) in pursuance of the said agreement and in consideration of the transfer by the party of the second part of the property more fully described in the Schedule II hereto to the party of the first part, the party of the first part hereby grants and transfers to the party of the second part II all the property more fully described in Schedule I hereto to hold the same to the party of the second part absolutely for ever.
- (2) In further pursuance of the said agreement and in consideration of the transfer by the party of the first part of the property in Schedule I hereto to first part of the property in Schedule I hereto to the party of the second part, the party of the second part, hereby grants and transfers to the party of the first part of the shares more fully described in Schedule II hereto to hold the same to the party of the first part absolutely for ever.
- (3) each of the parties hereby covenants (*sic*) with the other first that the properties hereby transferred by him is free from encumbrance charge or lieu of any kind whatsoever. Secondly that the properties so transferred by each of them shall be quietly entered upon held and enjoyed by the other of them and the rents and profits and dividends received by the other of them without any interruption of disturbance by the party transferring the same or any one claiming through or under them thirdly that each of the parties hereto will at the request of and cost of the other execute every such assurance and so every such act or thinking as shall reasonably be required by such other for further or more.

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- A (4) The party of the first part covenants and assurances the party of the second part that all taxes due to the Government or the local bodies and all bills for the supply of electrical energy goods and accessories all salaries due to the staff have been paid upto 9-9-1955 the date of transfer and that the party of the second part will be in no way liable for any act done or commission made by the Rajah of Bobbili.....”
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C On behalf of the appellant Mr. Narsaraju referred to the resolution of the Board of Directors dated September 9, 1955 in which it was resolved that the Managing Director will negotiate with the zamindar of Chikkavaram or his nominee for the sale of the Sree Rama Talkies with all its equipment etc. for a consideration of Rs. 1,20,000/- Mr. Narsaraju also referred to the preamble in which the resolution of the Board of Directors dated September 9, 1955 is quoted and also the resolution of the meeting of the general body of the assessee-company held on October 4, 1955 authorising the Managing Director to negotiate “for the sale of the entire concern known by the name of Sree Rama Talkies”. But, in our opinion, neither the recital in the preamble nor the resolution of the Board of Directors dated September 9, 1955 will control the language of the operative portion of the document or its legal effect. There is no ambiguity in the construction of the operative part. It is clear from the operative part of the document that there was an exchange of the properties described in Sch. I for 5% tax-free cumulative preference shares of Sri Rama Sugars & Industries Ltd., Bobbili. It is true that a valuation of Rs. 1,20,000/- was fixed to consist of Rs. 60,000/- for immovable properties and the goodwill and Rs. 60,000/- for movable properties, but that is only for the purpose of payment of stamp duty. In essence the transaction is one of exchange and there was no sale of the properties described in Sch. I for any money consideration. In other words, there was no price paid or promised to be paid for the transfer of the cinema house known as Sree Rama Talkies together with machinery and equipment described in Sch. I to the deed dated February 21, 1956 but there was a consideration in the shape of transfer of 5% tax-free cumulative preference shares of Sri Rama Sugar & Industries Ltd. It follows therefore that the Income-tax authorities were not entitled to treat the transaction dated February 21, 1956 as a sale and to apply the provisions of s. 10(2)(vii) of the Income-tax Act.

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H We pass on to consider the argument of Mr. Narsaraju that in revenue matters it was the substance of the transaction which must be looked at and not the form in which the parties

have chosen to clothe the transaction. It was contended that, in the present case, there was in substance a sale of Sree Rama Talkies by the assessee-company for a money consideration of Rs. 1,20,000/-, though the mode of payment was by transfer of shares and the resolution of the Board of Directors dated September 9, 1955 clearly indicated that the intention of the assessee-company was to sell Sree Rama Talkies along with its equipment concerned for a consideration of Rs. 1,20,000/-. In the present case, however, there is no suggestion on behalf of the appellant of bad faith on the part of the assessee-company nor is it alleged that the particular form of the transaction was adopted as a cloak to conceal a different transaction. It is not disputed that the document in question was intended to be acted upon and there is no suggestion of *mala fides* or that the document was never intended to have any legal effect. In the absence of any suggestion of bad faith or fraud the true principle is that the taxing statute has to be applied in accordance with the legal rights of the parties to the transaction. When the transaction is embodied in a document the liability to tax depends upon the meaning and content of the language used in accordance with the ordinary rules of construction. In *Bank of Chettinad Ltd. v. C.I.T. Madras*⁽¹⁾, it was pointed out by the Judicial Committee that the doctrine that in revenue cases the 'substance of the matter' may be regarded as distinguished from the strict legal position, is erroneous. If a person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown seeking to recover the tax cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In the *Duke of Westminster's case*⁽²⁾ deeds of covenant had been executed by the Duke in favour of employees in such amounts that the covenantees, if remaining in the Duke's service, would receive respectively sums equivalent to their wages and salaries. If they left the service of the Duke the payments would still have been due, but it was in nearly all instances explained to the employee that so long as the service continued, while the deed did not prevent his claiming ordinary wages in addition, it was expected that he would not do so. It was argued for the Crown that though in form a grant of an annuity, the transaction was in substance merely one where by the annuitant was to continue to serve the Duke at his existing salary, so that the annuity must be treated as salary. Neither the Court of Appeal nor the House of Lords agreed with this contention. To regard the payments under the deed as in effect payments of salary would be to treat a transaction of one legal character as if it were a transaction of a different legal

(1) 1940 I.T.R. 522.

(2) 19 T.C. 490.

A character. With regard to the supposed contrast between the form and substance of the arrangement, Lord Russell of Killowen stated at page 524 as follows :

B “If all that is meant by the doctrine is that having once ascertained the legal rights of the parties you may disregard mere nomenclature and decide the question of taxability or non-taxability in accordance with the legal rights, well and good. That is what this House did in the case of *Secretary of State in Council of India v. Scoble*, (1903) A.C. 299 (4 T.C. 618); that and no more. If, on the other hand, the doctrine means that you may brush aside deeds, disregard the legal rights and liabilities arising under a contract between parties, and decide the question of taxability or non-taxability upon the footing of the rights and liabilities of the parties being different from what in law they are, then I entirely dissent from such a doctrine.”

D In a later case—*Commissioners of Inland Revenue v. Wesleyan and General Assurance Society*⁽¹⁾ Viscount Simon expressed the principle as follows :

E “It may be well to repeat two propositions which are well established in the application of the law relating to Income Tax. First, the name given to a transaction by the parties concerned does not necessarily decide the nature of the transaction. To call a payment a loan if it is really an annuity does not assist the tax-payer, any more than to call an item a capital payment would prevent it from being regarded as an income payment if that is its true nature. The question always is what is the real character of the payment, not what the parties call it.

F Secondly, a transaction which, on its true construction, is of a kind that would escape tax, is not taxable on the ground that the same result could be brought about by a transaction in another form which would attract tax.”

G For the reasons already given we hold that the question has been rightly answered by the High Court in the negative and in favour of the assessee-company and this appeal must be dismissed with costs.

H R.K.P.S.

Appeal dismissed.

(1) 30 T.C. 11.