

THIRU AROORAN SUGARS LTD., MADRAS
v.
COMMISSIONER OF INCOME TAX, MADRAS

JULY 20, 1997

[SUHAS C. SEN AND S.P. KURDUKAR, JJ.]

Income Tax Act 1961 : Sections 2(1-A) & 10(1)—Agricultural income to be excluded from total income of assessee.

Section 295(2)(b)—Income derived partly from agriculture and partly from business—Computation of income—Liable to be taxed.

Income Tax Rules 1962 : Rule 7(1)—Computation of income chargeable to income tax—Market value of agricultural produce used as raw material in business—To be deducted.

Rule 7(2)(a)—Market value—Determination of—Average price during relevant previous year—Of goods ordinarily sold in the market—To be deemed market value.

Sugarcane Control Order : Regulation of production, distribution and price of sugarcane—Whether sugarcane ceases to be an agricultural produced 'ordinarily sold' in the market?—No.

Words and Phrases : 'Market and 'ordinarily sold'—Meaning of—In the context of Rule 7 of the Income Tax Rules 1962 :

The assessee company engaged in the manufacture of sugar, cultivated sugarcane in its own cane fields. The entire quantity of sugarcane produced by the assessee was consumed by the assessee itself. The assessee also purchased raw sugarcane for crushing from the market, as the quantity produced by it was not adequate for its requirement. During the period relevant for assessment years 1962-63, 1966-67 and 1967-68, when the Sugar-cane Control Order was in force, the quantity of sugarcane purchased by the assessee, from registered and non registered ryots far exceeded that produced by it.

The contention of the assessee was that since at the relevant time the sugar-cane prices were controlled by the Sugar-cane Control Order, the

A market value of the sugarcane produce, to be deducted from its income chargeable to income tax, was to be determined not according to clause (a) but as per clause (b) of sub-rule 2 of rule 7 of the income tax rules. Upholding this contention, the Tribunal took the view that sugarcane could not be treated as agricultural produce ordinarily sold in the market, during the relevant previous years.

B Taking a contrary view the High Court held that merely because the market for sugar-cane was regulated by the Sugar-Cane Control Order, the product itself did not cease to be an agricultural produce ordinarily sold in the market, and therefore the market value of the sugarcane produced by the assessee had to be computed in the manner laid down in Rule 7(2)(a). Aggrieved by this, the assessee company preferred the present appeal.

C It was argued on behalf of the assessee that rule 7(2)(a) is applicable only where there exists an actual market where sugarcane is ordinarily sold and where buyers and sellers congregate for the sale and purchase of goods, and that the market value of goods could not be determined in the absence of such a market.

D Dismissing the appeal and upholding the decision of the High Court, this Court

E HELD : 1. The High Court has come to a right decision in holding that Rule 7(2)(a) was applicable in this case. The market value of the sugarcane produced and consumed by the assessee company was to be computed accordingly. [157-A]

F 2. The product itself does not lose its identity or nature or character of an agricultural produce sold in the market merely because the price, distribution, production and relationship between the grower and purchaser thereof, were subject to elaborate government/regulations.

G [156-G-H]

2.1. The assessee was itself purchasing sugarcane for its manufacturing purposes in the ordinary course of business. Thus, raw sugarcane was ordinarily sold in the market within the framework of Govt. regulations and the market value of the same had to be determined as provided in rule 7(2)(a). [158-E]

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3. For determining the market value of the sugarcane produced by the assessee, the fact that the price of such goods was controlled was immaterial. The price at which the assessee bought sugarcane must be taken as the market price. [160-F] A

3.1. If the price is controlled by government regulations, the controlled price at which the buyer and seller are reasonably expected to transact business, will be taken as the market price. [160-G] B

4. 'Market' in the context of Rule 7 does not mean an open market where buyers and sellers congregate to buy and sell goods. To apply Rule 7(2)(a) it is sufficient that the product is bought and sold for a price, in the ordinary course of business. [157-E-F] C

4.1. The place of sale or purchase or delivery of the goods is immaterial for deciding whether there was a market for sugarcane or not. The position would not differ even if the assessee is the only buyer in the region where its factory is located. [160-E; H] D

Ahmed G.H. Ariff & Ors. v. CWT, Calcutta, 76 ITR 471, relied on.

Gift Tax Officer, Calcutta & Anr. v. Kastur Chand Jain, 53 ITR 411, approved. E

J.M. Casey v. CIT, Bihar & Orissa, AIR (1930) Patna 44, distinguished.

Building & Civil Engineering Holidays Scheme Management Ltd. v. Post Office, (1966) 1 QB 247, referred to. F

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 6635 of 1983 Etc. Etc.

From the Judgment and order dated 7.12.82 of the Madras High Court in T.C. No. 373 of 1977. G

F.S. Nariman, R.F. Nariman and P.H. Parekh for the Appellants.

T.L.V. Iyer for the Respondent.

The Judgment of the Court was delivered by H

A SEN, J. The assessment years in this group of appeals (C.A. No. 6636/83, 6637/83, 6638/83, 6639/83, 6640/83 and 175-77/85) are 1962-63 to 1967-68. The assessee-company, Thiru Arooran Sugar Ltd., is a manufacturer of sugar which purchases sugarcane from the market for crushing. It also has its own cane fields where it cultivates sugarcane which is entirely consumed by its factory. Since the profits made by the assessee from the sale of sugar arises out of agricultural activities as well as the manufacturing activities, the income earned by the assessee has to be divided into two parts. No tax is leviable under the Income Tax Act on agricultural income but the profit generated by the non-agricultural activities is liable to be taxed under the Act. There is no dispute that the income attributable to the agricultural activities must be excluded from the income earned by the assessee from the sale of sugar. But the problem is of computation of such income.

D Section 10(1) of the Income-tax Act lays down that the agricultural income shall not be taken into computation of the total income of a previous year of any person under the Income-tax, 1961. Section 295 of the Act which empowers the Board to make rules for carrying out the purposes of this Act has specifically empowered the Board by sub-section (2)(b) of Section 295 to frame Rules for the manner in which and the procedure by which the income shall be arrived at in the case of, *inter alia*, income derived in part from agriculture and in part from business. In exercise of this power Rule 7 of the Income-tax Rules, 1962 was framed which lays down :

"Income which is partially agricultural and partially from business-

F (1) In the case of income which is partially agricultural income as defined in section 2 and partially income chargeable to income-tax under head "Profits and gains of business", in determining the part which is chargeable to income-tax the market value of any agricultural produce which has been raised by the assessee or received by him as rent-in-kind and which has been utilised as a raw material in such business or the sale receipts of which are included in the accounts of the business shall be deducted, and no further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent-in-kind.

H (2) For the purposes of sub-rule (1) "market value" shall be deemed

to be -

(a) Where agricultural produce is ordinarily sold in the market in its raw state, or after application to it of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render it fit to be taken to market, the value calculated according to the average price at which it has been so sold during the relevant previous year;

(b) Where agricultural produce is not ordinarily sold in the market in its raw state or after application to it of any process aforesaid, the aggregate of -

(i) the expenses of cultivation;

(ii) the land revenue or rent paid for the area in which it was grown; and

(iii) such amount as the (Assessing) Officer finds, having regard to all circumstances in each case, to represent a reasonable profit."

Sub-rule (1) of Rule 7 lays down that market value of the agricultural produce raised by the assessee will have to be deducted from the business account of the assessee. The 'market value' spoken of in sub-rule (1) will have to be determined in the manner laid down in sub-rule (2). Sub-rule (2) lays down in clause (a) the well-known formula of average price of the goods ordinarily sold in the market as market value of the goods. The formula contained in clause (b) will only apply in cases where agricultural produce is not ordinarily sold in the market in its raw state or after any process applied to it to make it marketable.

The assessee's contention is that the market value of the sugarcane which has been produced and consumed by the assessee must be determined in the manner laid down in sub-rule (2)(b) of Rule 7. The contention of the Revenue is that the procedure laid down in clause (a) of sub-rule (2) will be the right procedure to follow. The Tribunal was of the view that the procedure laid down in clause (b) had to be resorted to because the price of sugar was controlled by the Sugarcane Control Order at the material time. The High Court was of the view that the Sugarcane Control Order notwithstanding there was a market for sugarcane and even if the

A assessee consumes the entire quantity of sugarcane raised by it the market price of such sugarcane is ascertainable and this price has to be excluded from profit and gains of business of the assessee.

B The Tribunal found that the assessee Company had grown sugarcane in its own land as well as lands taken on lease. Since the crushing capacity of the assessee's factory was 1200 tons per day, the sugarcane grown by the assessee was not adequate for its requirement. It had, therefore, purchased sugarcane from other growers. The sugarcane purchased by the assessee was much more than the sugarcane produced by it for the assessment years 1962-63, 1966-67 and 1967-68. The assessee purchased sugarcane from the registered ryots according to the provisions of the Sugarcane Control Order and also from non-registered ryots. The quantity of sugarcane purchased from the non-registered ryots was negligible compared to the quantity of sugarcane purchased from the registered ryots except during the periods relevant for assessment years 1962-63, 1963-64 and 1966-67. C
D The Tribunal was of the view that sugarcane could not be treated as agricultural produce ordinarily sold in the market during the relevant previous years. Therefore, it upheld the contention made on behalf of the assessee-company that sugarcane produced by it had to be valued in accordance with Rule 7(2)(b).

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The High Court took a contrary view. The High Court took note of the fact that for some of the years under consideration in this case the average cost of cultivation shown by the assessee was more than the average cost of purchase. The assessee was really trying in those years to get deductions of a higher figure than the market value of the sugarcane produced by it. The High Court pointed out that the Tribunal had not come to a finding of fact that sugarcane was not ordinarily sold in the market in its raw state in the area where the factory of the assessee was located. Sugarcane, as a matter of fact, was sold in the market in raw state, even before the Sugarcane Control Order came into force. Because of the F
G Control Order, sugarcane did not cease to be a produce ordinarily sold in the market. The Control Order merely regulated the market for raw sugarcane. Merely because the price, the distribution, the production, the relationship between the grower and the purchaser, were all subjected to elaborate Government regulation, it could not be said that the product H
itself lost either its identity or its nature or its character of an agricultural

produce sold in the market. The High Court held that Rule 7(2)(a) will clearly apply in this case and market value of sugarcane produced and consumed by the assessee-company had to be computed accordingly. A

Under Rule 7(1), in computing the profits and gains of business, market value of an agricultural produce in raw state has to be deducted from the profits of partly agricultural and partly industrial products. Sub-rule (2) lays down the method of computation of market value. If the agricultural produce is ordinarily sold in the market, Rule 7(2)(a) will apply. If not, Rule 7(2)(b) will apply. The question, therefore, is was sugarcane ordinarily sold in the market in raw state? The answer must be in the affirmative. The assessee-company itself was buying more sugarcane, than it was producing, from registered and unregistered ryots. B C

Mr. Nariman on behalf of the assessee had argued that in order to invoke Rule 7(2)(a) it has to be found that a market exists where sugarcane is ordinarily sold. This implies that there will be a market of a nature when buyers and sellers congregate. If such a market does not exist, the provisions of Rule 7(2)(a) will not apply. Sub-rule (b) was framed by the Board to determine the value of agricultural products where such markets for agricultural products did not exist. D

We are unable to uphold this argument. "Market" in the context of Rule 7 does not mean an open market where buyers and sellers get together for the purpose of purchase and sale of goods. The assessee-company regularly, year after year, in ordinary course of business bought sugarcane from registered and unregistered ryots. Whether the purchase was at a price controlled by the Sugarcane Control Order or not is quite immaterial. There was a price at which sugarcane could ordinarily be purchased by the assessee for the purpose of its own business. The price paid by the assessee was the market price. It is by now well-settled that market does not have to be one open place of business where buyer and seller congregate. E F G

If the market is controlled by Government regulation, sale and purchase of sugarcane within the framework of these regulations will be the ordinary mode of selling sugarcane. No special significance can be read into the phrase 'ordinarily sold'. It is not disputed that the assessee utilises sugarcane grown by it in its own field for its factory and also purchases a H

A considerable amount of sugarcane from outside. Therefore, it is not the case of the assessee that sugarcane growers do not sell sugarcane in ordinary course of their business in the region where the assessee carries on business.

B Mr. Nariman next contended that the assessee was buying sugarcane at its own factory gate. There is no other factory in the region where the assessee's factory was situated. The area adjoining the factory gate could not be treated as marked for sugarcane. In the facts of this case there was no way to find out the average price of the sugarcane which was being sold in the market in ordinary course during the previous years. In support of this Contention, Mr. Nariman relied on a Special Bench decision of the Patna High Court in the case of *J.M. Casey v. Commissioner of Income-tax, Bihar & Orissa*, AIR (1930) Patna 44.

D This argument again is misconceived. The place where the sugarcane was bought and sold is quite immaterial for deciding whether there was a market for sugarcane or not. The place of delivery of the goods may be decided by the buyer and seller by mutual consent, express or implied. The assessee might have purchased and taken delivery of the goods from the seller's doorsteps. The point that has to be borne in mind is that in order to apply Rule 7(2)a), existence of an open market where buyers and sellers come together to do business is not an essential pre-requisite.

F We are unable to uphold the contention of Mr. Nariman that where the buyer was only one and the sellers were many it cannot be said that the sale was in a market and the price was market price. The case of *J.M. Casey* (supra) was decided by a Special Bench of the Patna High Court in the special and unusual facts of that case. The Special Bench considered the scope and effect of Section 2(1)(b) of the Indian Income-tax Act. It was observed that the word "market" in that section implied a real centre of economic exchange. The implication of this observation has to be understood in the facts of that case. Motihari Jail purchased aloe plants, the principal use of which was to provide hedges. Manual production of fibre out of these plants involved a very rough, laborious and uneconomic procedure. Motihari Jail bought a small quantity of aloe leaves from cultivators not for any commercial purpose but to keep the prisoners occupied. The purchase by the jail was not a commercial activity at all.

H Courtney Terrel, C.J. explained the position thus :

"The object of the manufacture in jails is not the conducting of an economic process which shall render profitable the cultivation of the aloe plant but merely to keep the prisoners employed on sufficiently laborious and punitive work." A

It was held in the facts of that case that purchase of aloe leaves by jails in an artificial condition had no relation to a market for agricultural produce. But in the case before us, the purchases of sugarcane made by the factory were purely commercial transactions controlled by market forces within the framework of the Sugarcane Control Order. The Special Bench decision of the Patna High Court does not support the case made out by Mr. Nariman in any way. B C

The principle that value of a property will be the price which it will fetch if sold in the open market is a well-known method of valuation which has been adopted in a large number of statutes in England and also in India. It is well-settled that existence of an open market is not a pre-condition for application of this principle. There may or may not be an actual market where buyers and sellers congregate to purchase and sell goods. Where there is no such open market an estimate of the market price will have to be done on a hypothetical basis. In a case under the Gift-Tax Act, *Gift-Tax Officer, Calcutta & Anr. v. Kastur Chand Jain*, 53 ITR 411, dealing with Section 6(1) of that Act, R.S. Bachawat, J. observed : D E

"The basic principle of valuation is embodied in section 6(1) of the Gift-Tax Act, 1958, and in the corresponding section, section 36 of the Estate Duty Act, 1953, and section 7(1) of the Wealth-Tax Act, 1957. The valuer has to find "the price which.....it would fetch if sold in the open market". The measure of value of the property is the price which the hypothetical buyer in an open market would pay for it." F

In the case of *Ahmed G.H. Ariff & Ors. v. Commissioner of Wealth-Tax, Calcutta*, 76 ITR 471 explaining the phrase "if sold in the open market" in Section 7(1) of the Wealth-Tax Act, it was observed by Grover, J. speaking for the Court that the phrase did not contemplate actual sale or the actual state of the market, but only enjoined that it should be assumed that there was an open market and the property could be sold in such a market and, on that basis, the value had to be found out. It was a G H

- A hypothetical case which was contemplated and the tax officer must assume that there was an open market in which the asset could be sold.

In view of the aforesaid, it is very difficult to uphold the contention of Mr. Nariman that in order to find the market price there has to be an actual market where there will be 'a concourse of buyers and sellers'. This argument was specifically rejected by Lord Pearson L.J. in the case of *Building and Civil Engineering Holidays Scheme Management Ltd. v. Post Office*, (1966) 1 QB 247 in the following words :

- C "What is meant by "market value"? It is not reasonable to suppose that for the purposes of this proviso there is no market value unless there is a concourse of buyers and sellers. There is no need to infer that there must be an open market, or that there must be a price fluctuating according to the pressures of supply and demand."

- D In that case Lord Denning also explained the concept of market value in the following words :

- E "What is the "market value" of these stamps? It does not connote a market where buyers and sellers congregate. The "market value" here means the price at which the goods could be expected to be bought and sold as between willing seller and willing buyer, even though there may be only one seller or one buyer, and even though one or both may be hypothetical rather than real".

- F These are the principles universally applied to find out the price at which the goods are ordinarily sold in the open market. For determination of the market value, there is no pre-requisite that an open market where buyers and sellers congregate to buy and sell goods must exist. In the instant case, the assessee-company actually bought sugarcane from a large number of growers year after year in ordinary course of business. The price

- G at which it buys sugarcane must be taken to be the market price. If the price is controlled by Sugarcane Control Order the controlled price will be taken as the market price because it is at this price that a willing buyer and a willing seller are expected to transact business. As Lord Denning pointed out, it does not make any difference to this position that the assessee was

- H the only buyer in the region where its factory located.

In the facts of this case, we are of the view that the High Court has come to a right decision. The appeals are without any merit and are dismissed. There will be no order as to costs. A

C.A. No. 3674/1989, C.A. No. 2399 (NT)/1989 and S.L.P. No. 2611/1988

Mr. Nariman has argued that there are certain facts in these cases which were not brought to the notice of the Tribunal. Therefore, in these cases, there should be a direction by this Court to the Tribunal to investigate those facts. B

It is not possible to accede to this prayer. Certain questions of law on the basis of the facts and circumstances found by the Tribunal have been referred to the High Court for its opinion. The High Court has given its opinion on those questions on the basis of facts found by the Tribunal. The Tribunal is the final fact finding authority. The High Court cannot go behind the facts found by the Tribunal. It was for the assessee to raise questions of fact at the time of hearing of the appeal before the Tribunal. At the reference stage, no fresh investigation into facts is permissible. There may be cases where the Court feels that it is unable to answer the question of law referred because findings of fact are incomplete. In such cases, the Court may call for a supplementary statement from the Tribunal. But that is not the case here. The High Court did not feel any difficulty in answering the question on the basis of the facts found. The assessee's prayer is for a direction to the Tribunal to consider new questions of fact which were not raised before the Tribunal at all. We see no reason to grant this prayer at this stage. C
D
E

These appeals must also fail and are dismissed. The Special Leave Petition No. 2611 of 1988 is also dismissed. There will be no order as to costs. F

R.C.

Appeals/Petition dismissed. G