

(1971) 09 GUJ CK 0009
In the Gujarat High Court

Case No : Income-tax Reference No's. 3 and 4 of 1970

AMRITLAL CHHAGANLAL (DECEASED) AND ANOTHER (BY
LEGAL REPRESENTATIVE) APPELLANT

Vs

COMMISSIONER OF Income Tax, GUJARAT. RESPONDENT

Date of Decision : 06-09-1971

Acts Referred:

Citation : (1972) 84 ITR 677

Hon'ble Judges : Bhagwati, C.J.;Bhagwati, J

Bench : Division Bench

Judgement

The judgment of the court was delivered by

BHAGWATI C.J. - These two references raise a common question of law and they are also based on substantially similar facts and it would, therefore, be convenient to dispose them of by a single judgment. We will first state the facts giving rise to Income Tax Reference No. 3 of 1970. The assessee in Income Tax Reference No. 3 of 1970, since deceased, was a partner in the firm called Messrs. Dalwadi and Company. The assessee owned a piece of agricultural land in or around the city of Ahmedabad. By an oral contract the assessee authorised Messrs. Dalwadi and Company to enter upon his land and to dig and remove earth from the land for being used for manufacturing bricks. The statement of the case does not show what was the consideration for which this authorisation was granted by the assessee but we were told by the counsel for the assessee, and this was not disputed on behalf of the revenue, that the consideration payable by Messrs. Dalwadi and Company was Rs. 2 per thousand bricks manufactured out of the earth removed by them. Pursuant to this contract, Messrs. Dalwadi and Company dug and removed earth from the land of the assessee to the extent of the value of Rs. 9,060 during Samvat year 2017, being the relevant previous year for the assessment year 1962-63. The question arose in the assessment of the assessee to Income Tax for the assessment year 1962-63, whether this sum of Rs. 9,060 received by the assessee from Messrs.

Dalwadi and Company constituted income liable to tax in the hands of the assessee. The assessee claimed that it was not so liable and the contention put forward by him was a two-fold contention. In the first place, it was contended by the assessee that the receipt of the sum of Rs. 9,060 was capital receipt and not revenue and the second contention was - and that was a contention in the alternative - that even if this receipt was income receipt, it bore the character of agricultural income and was, therefore, exempt from tax. Both these contentions were negated by the Income Tax Officer and the sum of Rs. 9,060 was included in the total income of the assessee. The assessee being dissatisfied with this decision of the Income Tax Officer preferred an appeal to the Appellate Assistant Commissioner but the appeal was unsuccessful. The assessee thereupon carried the matter in further appeal to the Tribunal but this appeal also met with the same fate. The assessee thereupon made an application to the Tribunal for reference of certain questions of law which arose out of the order of the Tribunal and on the application, the following questions of law were referred for the opinion of this court :

"(1) Whether the receipt of the amount of Rs. 9,060 which the appellant has realised from the sale of earth dug out from the agricultural land of his ownership is agricultural income ?

(2) Whether the said receipt amounts in law to a receipt of capital nature or revenue nature ?"

The same sequence of events also followed in the case of the assessee in Income Tax Reference No. 4 of 1970. The assessee in Income Tax Reference No. 4 of 1970 is the daughter-in-law of the assessee in Income Tax Reference No. 3 of 1970 and she too had entered into a similar contract with Messrs. Dalwadi and Company in respect of her agricultural land authorising Messrs. Dalwadi and Company to enter upon the land and to dig and remove earth for being used for manufacturing bricks on the same terms. The amount received by her during Samvat year 2017 from Messrs. Dalwadi and Company under this contract was the same, namely, Rs. 9,060 and the same question, therefore, arose also in her assessment for the assessment year 1962-63. She raised the same contentions and they were rejected successively by the Income Tax Officer, the Appellate Assistant Commissioner and the Tribunal. She, therefore, made an application for reference and on her application, identical questions were referred to us for our opinion as in the case of the assessee in Income Tax Reference No. 3 of 1970.

Of the two questions referred to us for our opinion the first was not pressed by the learned counsel for the assessee in view of the decision of the Supreme Court in Commissioner of Income Tax v. Raja Benoy Kumar Sahas Roy. We need not, therefore, deal with it. The second question was the one which was seriously debated before us and it raised the familiar question which arises all too frequently in cases under the Income Tax legislation, namely, whether a particular receipt sought to be taxed in the hands of the assessee constitutes capital receipt or revenue receipt. There have been many cases where this

question has been the subject-matter of judicial decision. But experience shows that a large number of these cases fall on the borderline indeed, in many cases, as observed by Greene M. R., "the spin of a coin would decide the matter almost as satisfactorily as an attempt to find reasons. "Here also we find ourselves in the same predicament and our predicament is heightened by the fact that there is no decided case which serves as a guide for determination of the precise question which has arisen before us.

Now while dealing with this question it is merely at the outset to clear the ground by pointing out that merely because the earth would be consumed and exhausted in the process of digging and removal, that would by itself be no ground for holding that the consideration received for it is capital receipt and not income receipt. It is now well-settled since the decision of the House of Lords in *Coltress Iron Co. v. Black*, that profits from capital which is consumed and exhausted in the process of realisation may none-the-less be taxable as income. This principle has been applied in case of diverse kinds of wasting assets and it has been consistently held that income derived from mines and quarries, vide *Kamakshya Narain Singh v. Commissioner of Income Tax*, nitrate grounds, vide *Alianza Co. Ltd. v. Bell*, and timber-bearing forests, vide *Kauri Timber Co. Ltd. v. Commissioner of Taxes* is not realisation of capital but is taxable as income regardless of the consumption of capital involved in the process of profit earning. We may in this connection usefully refer to the following passage from the judgment of Lord Wright in *Kamakshya Narain Singhs* case :

"If the receipts are income, it is not material for tax purposes that that for which they are paid comes from a wasting property. If the payment ceases because the source ceases, so does the tax. Once it is established that the royalties are income within the meaning of the Act it is not material that the mines are in course of being exhausted....."

It would seem from these decided cases that exhaustion of capital by exploitation of wasting assets such as mines, quarries, nitrate grounds and timber-bearing forest, howsoever it might be treated on strict actuarial principles or on strict principles of economics, may yet result in receipt which would for the purposes of levy of Income Tax be liable to be regarded as revenue receipt. It is, therefore, immaterial to the question of determination of the nature of the receipt whether, in the process of earning it, the capital asset is consumed and exhausted.

What then is the test for the purpose of distinguishing between capital receipt and revenue receipt in cases of this kind ? The broad test to be applied in such cases was formulated by Lawrence J. in *Greyhounds* case, in these words :

"The question as to what receipts are revenue and what are capital has given rise to much difference of opinion; but it is clear, in my opinion, that, if the sum in question is received for what is in truth the user of capital assets and not for their realisation, it is a revenue receipt, not capital."

This same test was adopted by the Privy Council in *Kamakshya Narain Singhs*

case, where one of the questions which arose for determination was whether royalties payable by the lessee to the lessor in respect of a mining lease on the basis of tonnage of coal extracted and removed was capital or revenue receipt. The mining lease contained covenants granting several benefits to the lessee which included, inter alia, liberties to do various things upon the land. Lord Wright, delivering the opinion of the Judicial Committee, analysed the nature of the royalties payable under the mining lease and observed :

"These are periodical payments, to be made by the lessee under his covenants in consideration of the benefits which he is granted by the lessor. What benefits may be shown by the extract from the lease quoted above, which illustrates how inadequate and fallacious it is to envisage to royalties as merely the price of the actual tons of coal. The tonnage royalty is indeed only payable when the coal or coke is gotten and dispatched : but that is merely the last stage. As preliminary and ancillary to that culminating act, liberties are granted to enter on the land and search, to dig and sink pits, to erect engines and machinery, coke ovens, furnaces and form railways and roads. All these and the like liberties show how fallacious it is to treat the lease as merely one for the acquisition of a certain number of tons of coal, or the agreed item of royalty as merely the price of each ton of coal. The contract is in truth much more complex. The royalty is in substance a rent : it is the compensation which the occupier pays the landlord for that species of occupation which the contract between them allows, to quote the words of Lord Denman in *R. V. Westbrook*. He was referring to leases of coal mines, clay pits and slate quarries. He added that in all these the occupation was only valuable by the removal of portions of the soil.... the royalties here are clearly income and not capital. They are periodical payments for the continuous enjoyment of the various benefits under the leases. The actual acquisition of the property in a particular ton of coal at the moment when the lessees have cut and taken away the coal is only the final stage."

The Privy Council construed the mining lease as a grant of the occupation and use of the land for the purpose of doing various things on the land with the ultimate object of extracting coal and removing it and held that the tonnage royalty payable under the mining lease was rent or compensation for such occupation and use of the land. The mining lease was not treated as a transition for realisation or sale of coal lying embedded beneath the land. Though no reference was made in the judgment to *Greyhounds* case nor did the Privy Council refer to the test enunciated by Lawrence J., it is evident from the passage quoted above, that the Privy Council applied this very test for the purpose of determining whether the tonnage royalty constituted capital or revenue receipt. Since, on the view taken by the Privy Council, the tonnage royalty was received by the lessor for occupation and use of the land and not by way of realisation of the value of coal lying embedded beneath the land, the Privy Council held that it was income and not capital.

The same test was also approved by the Supreme Court in *Chintamani Saran*

Nath Sah Deo v. Commissioner of Income Tax. There what was granted to the license was prospecting license which conferred on the license a right to enter upon the land, to prospect, search for, mine, quarry, bore, dig and prove all bauxite lying and being in, under or within the said land and for that purpose the licensee was also given the right to dig pits, shafts, borings and to remove, take away and appropriate samples and specimens of bauxite of every quality, kind and description and in reasonable quantities not exceeding one hundred tons in the aggregate. This right was, to use the words of Kapur J., "a right to a portion of the capital in the shape of a general right to the capital asset" and for grant of this right, a lump sum payment was made by the licensee to the owner of the land. The question arise whether this lump sum payment constituted capital or revenue in the hands of the owner. The Supreme Court, after referring to the test formulated by Lawrence J. observed :

"The terms of the covenant in the present case which have been quoted above show that the transaction was not one merely of the user of capital assets but of their realisation. By this test, therefore, the receipts were on capital account and not revenue."

The lump sum received by the owner from the licensee for grant of the prospecting license was thus held to be capital and not revenue receipt on the application of the test formulated by Lawrence J.

We must, therefore, apply the test formulated by Lawrence J. for the purpose of determining whether the amount received by the assessee in the present case from Messrs. Dalwadi and Company constituted capital or revenue. We must ask ourselves the question whether this amount was received as rent or compensation for occupation and use of the land for the purpose of digging and removal of earth or it was by way of realisation of the value of earth dug out and removed which constituted a portion of the capital asset of the assessee. If it fell within the former category, it would be revenue but if it fell within the latter, it would be a capital. We may make it clear at this stage that even if the transaction between the assessee and Messrs. Dalwadi and Company was in substance a transaction for realisation of the value of earth dug and removed by means of sale, a question might well have arisen whether sale of earth in this manner constituted a business activity of the assessee but that question does not arise here, since it was at no stage the case of the revenue that sale of earth by the assessee by authorizing Messrs. Dalwadi and Company to dig and remove it constituted a business activity of the assessee and though the Accountant Member of the Tribunal seems to have proceeded on some such ground, it cannot be sustained, as there are no facts on record which would support such conclusion. The only question beforeus, therefore, is whether the amount received by the assessee was by way of rent or compensation for occupation and use of the land for the purpose of digging and removal of the earth or it represented the price of the earth dug and removed by Messrs. Dalwadi and Company. To determine this question, we must examine the nature of the grant

made by the assessee to Messrs. Dalwadi and Company.

If we look at the record of the case which is before us, we must confess that it is very sketchy and the only facts which appear from the record are that there was an oral contract between the assessee and Messrs. Dalwadi and Company under which Messrs. Dalwadi and Company were entitled to enter upon the land of the assessee and to dig and remove earth from it and they were to pay consideration for it at the rate of rupees two per thousand bricks manufactured out of the earth so removed. The amount of consideration payable by Messrs. Dalwadi and Company to the assessee was to be calculated by reference to the volume of earth dug and removed by them. The only work to be done by Messrs. Dalwadi and Company on the land of the assessee was digging and removal of earth. The record does not show that any other work was to be done by them on the land. It is difficult to see how in these circumstances the transaction could be regarded as one granting occupation and use of the land for the purpose of digging and removal of earth. The transaction was plainly and manifestly a transaction of sale of earth to be dug and removed by Messrs. Dalwadi and Company. It is not possible to equate this transaction with the complex contract which came up for consideration before the Privy Council in *Kamakshya Narain Singhs case*. If the nature of the transaction with Messrs. Dalwadi and Company had been such that it permitted them to set up a brick kiln on the assessee's land and make payment to the assessee against every lot of one thousand bricks manufactured in the kiln out of earth dug and removed by them, it might have been possible to argue with some degree of plausibility that it was a contract in which payment was to be made not merely for the value of the earth dug and removed but as rent or compensation for occupation and use of the land for the purpose of removal of the earth, as was the case in *Janki Kuer v. Commissioner of Income Tax*, but the contract here was a simple contract which involved no more than realisation of value of earth to be dug and removed by Messrs. Dalwadi and Company without any other operation having to be done on the land. We may pause for a moment and consider what other form the transaction could have taken if the assessee in fact wanted to sell earth to Messrs. Dalwadi and Company and instead of removing it himself and selling it, desired that Messrs. Dalwadi and Company should dig and remove it. It is obvious that the transaction could not have taken any other form than the one before us. It is, therefore, clear that the transaction in the present case was one for sale of earth to be dug and removed by Messrs. Dalwadi and Company and the amount received by the assessee was by way of realisation of the value of earth dug and removed by them. It was by way of realisation of a portion of his capital asset and not as rent or compensation for use of it, that the assessee received the amount in question from Messrs. Dalwadi and Company. The amount, therefore, represented capital receipt and not revenue receipt.

Our answer to the second question in both the references, therefore, is that the amount of Rs. 9,060, realised by the assessee from the sale of earth dug out from the agricultural land, represents capital receipt and not revenue receipt. So

far as the first question in both the reference is concerned, it does not arise in view of our answer to the second question and, in any event, it does not need to be answered, as the learned counsel for the assessee has not pressed it. The Commissioner will pay the costs of the assessee in each of the two