

(1995) 10 KAR CK 0012
In the Karnataka High Court
Case No : ITRC No. 107 of 1993

Commissioner of Income Tax

APPELLANT

Vs

Dr. V.V. Mody

RESPONDENT

Date of Decision : 30-10-1995

Acts Referred:

Income Tax Act, 1961 — Section 45

Citation : (1996) 130 CTR 388 : (1995) ILR (Kar) 3349 : (1996) 218 ITR 1 :
(1996) 40 KarLJ 583

Hon'ble Judges : T.S. Thakur, J;S.A. Hakeem, J

Bench : Division Bench

Advocate : Deokinandan, for the Appellant; K.M.L. Majele, for the Respondent

Judgement

Tirath S. Thakur, J.—The Income Tax Appellate Tribunal, Bangalore has at the instance of the Revenue, referred the following two questions for the opinion of this Court :

(1) Whether, on the facts and in the circumstances of the case, the Tribunal is right in law in observing that a part of the property transferred was a short-term capital asset and the remaining alone was a long-term capital asset ?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal is right in law in holding that 50% of the selling price of Rs. 1,69,200 received by the assessee on account of sale made on 27th Nov., 1982, be taken as consideration received by him on account of sale of short-term capital asset and the remaining 50% shall be treated as consideration received on transfer of a long-term capital asset ?

2. The assessee, an individual, was allotted a site by the Bangalore Development Authority on the 25th May, 1972 in accordance with the relevant rules of allotment. A lease-cum-sale agreement was executed according to which the assessee was required to pay a certain amount to the Bangalore Development Authority and at the end of the 10th year, secure a conveyance in his favour

upon payment of the entire sale consideration. Consequently, a sale-deed was executed in favour of the assessee by the Bangalore Development Authority on the 29th March, 1982, registered on the 13th May, 1982. Shortly, thereafter, on 27th Nov., 1982, the assessee sold the site to a third person for a total consideration of Rs. 1,69,200.

3. In the assessment proceedings for the year 1983-84 the assessee appears to have contended that he had held the property in question since the date of its allotment in his favour, namely, the 25th May, 1972, and therefore, the gain arising out of the sale of the said site could be treated only as a long-term capital gain. The ITO, however, took the view that the assessee had held the property in question w.e.f. the 29th March, 1982, onwards and that he having sold the same on 27th Nov., 1982, it was a case of short-term capital gains.

4. Aggrieved by the order passed by the ITO, the assessee filed an appeal before the CIT(A), who following an earlier decision of the Tribunal, Delhi Bench in the case of Des Raj Nagpal vs. ITO (1985) 13 ITD 800 (Del) concluded that the asset in question had been held by the assessee since 25th May, 1972.

5. The Revenue questioned the correctness of the above order in an appeal before the Tribunal, who took the view that the rights held by the assessee in the site in question on the basis of the lease-cum-sale agreement, were also in the nature of an asset held by the assessee and directed that out of the total sale price of Rs. 1,69,200, 50% should be considered to be a short-term while the remaining 50% as a long-term capital gains. On the same analogy the Tribunal further held that the amount paid to the Bangalore Development Authority should be divided in a similar fashion and that 50% of the same should be taken as cost of acquisition of a short-term and the remaining 50% as of a long-term capital gain.

6. We have heard learned counsel for the parties.

7. Two questions fall for consideration. These are :

(1) What was the asset that was transferred by the assessee giving rise to the capital gain in question and;

(2) Since when was the same held by the assessee.

The answers to these questions are straight and simple. The asset transferred was title in the site in question which the assessee held on the basis of a conveyance in his favour since 29th March, 1982. The question as to whether the gain arising from the said transfer was a long or short-term gain shall, therefore, have to be answered on the said basis.

8. The Tribunal has not, however, followed the above line of reasoning. It was of the opinion that what was transferred by the assessee to the purchaser in respect of the site comprised partly the rights that the assessee had acquired under the lease-cum-sale agreement and partly the reversionary rights retained

by the Bangalore Development Authority which came to be transferred finally in favour of the assessee only on 29th March, 1982. Proceeding on that basis the Tribunal split up the cost of acquisition as also the sale price into two halves one relatable to the acquisition of the rights under the sale-cum-lease agreement and the other to the transfer of title under the sale deed executed in favour of the assessee. The approach adopted by the Tribunal, implies as if the transfer made by the assessee pertained to both the lease rights as also title to the property which in turn means that as on the date of the transfer in favour of the purchaser the assessee combined in himself the dual capacity of being not only the owner of the property but also the lessee thereof. This approach of the Tribunal in our opinion is not legally sound and ignores the legal effect of the transfer of absolute title in favour of the assessee who was till 29th March, 1982, holding the site in question only on the basis of the lease-cum-sale agreement. The significance of this transfer is that the same brings about a merger of the lesser interest held by the assessee in the bigger estate acquired by him under the sale-deed in his favour. Merger implies the vesting of lesser rights held by an individual in the larger estate that he may acquire qua the property in question. It postulates the extinction of the lesser estate whenever the person holding any such estate acquires a greater estate in respect of the same property. In the event of the lesser and the greater estates coinciding in the same individual the lesser gets annihilated, drowned or sunk in the larger. The doctrine owes its origin to the English common law but with equity intervening, the position in England is that, merger would be deemed to take place only in case the party acquiring the larger estate intended so. This position is accepted even in India, except to the extent the statutory provisions like Transfer of Property Act mandate otherwise. It was so held by the Supreme Court in *Jyotish Thakur and Others Vs. Tarakant Jha and Others*, where the legal position was summarised by their Lordships in the following words :

"Statutory provisions as regards merger were made in the Transfer of Property Act in 1882 and in the Bengal Tenancy Act, in 1985 - which was later extended to Bihar. These statutory provisions have, admittedly, no application to the present case. The legal position as regards merger, apart from these statutory provisions, may be stated thus : That while the union of the superior and subordinate interests will not automatically cause a merger, merger will be held to have taken place if the intention to merge is clear and not otherwise. In the absence of any express indication of intention, the Courts will proceed on the basis that the party had no intention to merge and also if a duty lay on him to keep the interests separate. In deciding the intention of the party the Court will have regard also to his conduct."

9. In the instant case, the assessee held the site in question under an agreement of lease-cum-sale. It is not in dispute that in so far as an agreement to sell is concerned the same does not create any right in the property agreed to be sold.

10. The assessee, however, had a valuable interest in the site in question in his

capacity as a lessee of the same, and the terms of the agreement of lease-cum-sale, clearly entitled him to enjoy the possession of the site in question as a lessee on payment of the amount fixed under the said agreement. Assuming, therefore, that the lease rights which the assessee held under the aforesaid agreement was a "capital asset" within the meaning of s. 45 of the IT Act, the said rights being a lesser estate in comparison to the larger one representing the title over the property in question merged with the larger estate upon the assessee acquiring the title to the property under the said deed executed in his favour. This would be so, in the light of the specific provisions contained in s. 111(d) of the Transfer of Property Act, which reads thus :

"Sec. 111 : A lease of immovable property, determines :.....

(d) in case the interests of the lessee and the lessor in the whole of the property become vested at the same time in one person in the same right."

The above provision recognises, what is true even on first principles, i.e., a person cannot be a tenant and landlord qua the same property at the same time. The question of the assessee intending to keep the two capacities or estates, namely, one of leasehold rights and the other of ownership separately from each other or any such separation of the interests held by him being beneficial to the assessee, does not in our opinion arise. The questions of intention of the assessee or his interest could assume importance only in case the situation was not covered by the provisions of s. 111(d). Sec. 111(d) (supra), which clearly provides for determination of the lease and the extinction of the lease rights if the interests of the lessee and the lessor in the whole of the property become vested at the same time in one person in the same right. In other words, as from the date of the sale, in favour of the assessee the assessee had only one capacity to describe himself qua the land in question and that was the capacity of being the absolute owner of the same. It is in that capacity alone that the assessee transferred his title over the site in question in favour of the purchaser. The sale-deed did not, and could possibly not, describe the transfer made in favour of the purchaser to be, one of the rights which the assessee held in respect of the site prior to the sale thereof in his favour. All such rights has sunk or drowned in the larger estate and, therefore, stood extinguished. That being so, the Tribunal was not, in our opinion, justified in holding that the transfer made by the assessee in favour of the purchaser implied a transfer of lease rights held by the assessee prior to the sale as also transfer of the ownership rights acquired by him upon the transfer of the property in his favour. The legal effect of the transfer made in favour of the assessee was that he had become the absolute owner of the property and therefore all that he could convey and did actually convey to his transferee was the absolute title in the property, without any reference to any inferior rights that the assessee had held prior to his becoming owner. Seen from that angle, it is apparent that what the assessee transferred had been held by him only from the date of the sale in his favour and not earlier to that. Consequently, the question of splitting up of sale price or for that matter, the

amount paid on the acquisition of the asset for being treated separately for purposes of short term and long-term gains, did not arise.

11. Mr. Bhat, appearing on behalf of the assessee, however, argued that the lease rights held by the assessee were a capital asset within the meaning of s. 2(14) of the IT Act, 1961. He urged that the expression "property of any" kind appearing in the said provision was wide enough to include rights enjoyed by an assessee in respect of immovable property, no matter such rights were inferior to the rights of ownership over the same. Transfer of such rights, contended the learned counsel, could legitimately give rise to capital gains and inasmuch as the assessee had held the said rights for more than the period prescribed the same qualified for being treated a long-term capital gain.

12. The term capital asset as defined by s. 2(14) of the Act means property of any kind held by the assessee whether or not connected with his business or profession, but does not include the specified items of property. Leasehold rights held by an assessee do not fall under any one of the exclusions contemplated by the definition. The expression "property" is of the widest import and subject to any limitations which the context may require, it signifies every possible interest which a person can acquire, hold and enjoy - Refer Ahmed G.H. Ariff and Others Vs. Commissioner of Wealth Tax, Calcutta, . It is, therefore, true that if any one of such interests was alienable by the holder of the same, it could give rise to a capital gain short or long-term depending upon the period for which the interest was held by the person concerned.

13. The question, however, is not whether the leasehold right held by the assessee could independent of the sale in favour of the assessee have been treated as a property right capable of generating a capital gain in the hands of the assessee. The question really is as to whether any such right existed and could be transferred by the assessee after the same had merged in the larger estate acquired by the assessee. This is particularly so because what is transferred by the assessee is not the lesser interest held by him earlier to his becoming the absolute owner but the total interest acquired by him in the form of absolute title to the property, transferred. In the circumstances, unless it was possible for the assessee to hold the two estates simultaneously and independent of each other, the transfer of the title in the property could not be deemed to be transferring the lesser and the larger estates both so as to make them amenable to a process of splitting for purpose of taxing the capital gain arising as a short-term or long-term gain. This, however, was not so in the present case. As from the 29th March, 1982, the assessee held only one estate representing the title to the property in question and any capital gain arising from the transfer of the said estate made on 27th Nov., 1982, could only be giving rise to a short-term gain. The Tribunal was in these circumstances in error in holding otherwise.

14. In the light of what has been stated above our answer to both the questions referred is in the negative and against the assessee. The reference is accordingly disposed of without any orders as to costs.