

(1987) 10 AP CK 0019

In the Andhra Pradesh High Court

Case No : Writ Petition No's. 5641 of 1980, 2592 and 9605 of 1981, 7167 of 1982 and 1605, 2123 and 2211 of 1986

J. Raghottama Reddy, S. Mutyam Reddy, Anam Venkata
Subba Reddy and K. Thulasamma

APPELLANT

Vs

Income Tax Officer
 S. Venkataramana, S. Gopal Rao
and S. Kamala Vs Union of India

RESPONDENT

Date of Decision : 09-10-1987

Acts Referred:

Income Tax Act, 1961 — Section 139(2), 2(1), 2(14), 2(24), 45
Constitution of India, 1950 — Article 14

Citation : (1988) 169 ITR 174

Hon'ble Judges : B.P. Jeevan Reddy, J;A. Lakshman Rao, J

Bench : Division Bench

Advocate : S. Dasaratharama Reddi, K. Raji Reddy, S.R. Ashok, Mangu Venkata Rao, Y. Ratnakar and N.V. Ranganatham, for the Appellant; M. Suryanarayana Murthy and A.V. Krishna, for the Respondent

Judgement

B.P. Jeevan Reddy, J.—The petitioners question the legislative competence of Parliament to levy capital gains tax on transfer of agricultural lands situated within the limits of the municipalities (with a population of more than 10,000) and within a radius of 8 kilometres thereof. Article 14 of the Constitution is also brought in to impugn the validity of the levy. For the sake of convenience, we shall refer to the facts in W. P. No. 2592 of 1981.

2. The petitioner owns agricultural lands within a radius of 8 kms. of Nellore Municipal limits. He sold 5 acres out of it in July, 1976, for a consideration of Rs. 45,000. He did not submit a return showing any income on that account. Even otherwise, he is not an Income Tax assessee. The Income Tax Officer, D-Ward, Nellore, issued a notice u/s 139(2) of the Act, in response to which the petitioner filed a return declaring an income of Rs. 5,630 as capital gain arising out of the said transaction and Rs. 2,500 as agricultural income. The Income Tax Officer, by his order dated January 30, 1980, determined the capital gain in the hands of

the petitioner at Rs. 26,630 and levied a tax of Rs. 5,746. According to the petitioner, the land sold was always put to agricultural use and paddy was grown at the time of sale.

3. In the counter-affidavit filed by the respondents, the facts stated above are not denied. It is, however, submitted that the petitioner ought to have filed an appeal against the order of assessment order suffers from laches.

4. We may mention that in the other writ petitions, there is no specific allegation that the lands were being cultivated and were put to agricultural use at the time of transfer.

5. Section 45 of the Act makes the profits or gains arising from the transfer of a capital asset, effected in the previous year, chargeable to Income Tax under the head "Capital gains". Such capital gain is deemed to be the income of the previous year in which the transfer took place. The expression "capital asset" is defined in clause (14) of section 2. Until the assessment year 1970-71, "agricultural land in India" was excluded from the definition of "capital asset". By the Finance Act, 1970, however, sub-clause (iii) in clause (14) was substituted. For the words "agricultural land in India", the following sub-clause was substituted :

"(iii) agricultural land in India, not being land situate -

(a) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year; or

(b) in any area within such distance, not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (a), as the Central Government may, having regard to the extent of, and scope for, urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette."

6. As a result of this amendment, agricultural land situate within the jurisdiction of a municipality with population of not less than 10,000 and within such distance as may be notified, not exceeding a distance of 8 kms. thereof, became a capital asset. (The idea was to make it chargeable to capital gains tax, in the event of transfer). For this purpose, it is immaterial whether the land is actually under cultivation or not. Any land, whether agricultural or otherwise, situate within the specified area became a capital asset. The consequence, i.e., consequence intended and envisaged by Parliament, was that all transfers of agricultural land within the specified area during the previous year relevant to the assessment year 1970-71, became exigible to capital gains tax. However, by virtue of clause (viii) of section 47, introduced by the same Finance Act with

effect from the same date, "any transfer of agricultural land in India effected before the first day of March, 1970" was exempted from capital gains tax, with the result that not all transfers of agricultural land effected in the previous year relevant to the assessment year 1970-71 attracted capital gains tax; only the transfers which took place during the month of March, 1970, became so liable.

7. The expression "agricultural income" is defined in clause (1) of section 2. Prior to the amendment of this definition by the Taxation Laws (Amendment) Act, 1970, with retrospective effect from April 1, 1962, the definition read as follows :

"(1) "agricultural income" means -

(a) any rent or revenue derived from land which is used for agricultural purposes and its either assessed to land revenue in India or is subject to a local rate assessed and collected by officers of the Government as such;

(b) any income derived from such land by -

(i) agriculture; or

(ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market; or

(iii) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in paragraph (ii) of this sub-clause;

(c) any income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator or the receiver of rent-in-kind, of any land with respect to which, or the produce of which, any process mentioned in paragraphs (ii) and (iii) of sub-clause (b) is carried on :

Provided that the building is on or in the immediate vicinity of the land, and is a building which the receiver of the rent or revenue or the cultivator, or the receiver of rent-in-kind, by reason of his connection with the land, requires as a dwelling-house, or as a store-house, or other out-building."

(The definition in the 1922 Act is identical).

8. After the amendment, the definition now reads as follows :

"(1) "agricultural income" means -

(a) any rent or revenue derived from land which is situated in India and is used for agricultural purposes;

(b) any income derived from such land by -

(i) agriculture; or

(ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market; or

(iii) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in paragraph (ii) of this sub-clause;

(c) any income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator or the receiver of rent-in-kind, of any land with respect to which, or the produce of which, any process mentioned in paragraphs (ii) and (iii) of sub-clause (b) is carried on :

Provided that -

(i) the building is on or in the immediate vicinity of the land, and is a building which the receiver of the rent or revenue or the cultivator, or the receiver or rent-in-kind, by reason of his connection with the land, requires as a dwelling-house, or as a store-house, or other out-building, and

(ii) the land is either assessed to land revenue in India or is subject to a local rate assessed and collected by officers of the Government as such or where the land is not so assessed to land revenue or subject to a local rate, it is not situated -

(A) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year; or

(B) in any area within such distance, not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (A), as the Central Government may, having regard to the extent of, and scope for, urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette."

9. It may be noted that the proviso substituted by the Amendment Act is in two parts which we may refer to as "proviso (i)" and "proviso (ii)". Proviso (i) is a reproduction of the pre-existing proviso, while proviso(ii), however, contains two exceptions which are mentioned as (A) and (B). Exceptions (A) and (B) are verbatim reproduction of sub-clauses (a) and (b) (exceptions (A) and (B) as they may be called) in clause (iii) of the definition of "capital asset". The amendment of the definition of "agricultural income" is with retrospective effect, from the date of the commencement of the 1961 Act. According to this definition, agricultural income means (a) any rent or revenue derived from land in India, which land is used for agricultural purposes; (b) income derived from such land

by agriculture, or by other operations of the kind mentioned in clause (b); and (c) any income derived from any building owned and occupied by the person receiving the rent or revenue of the land, mentioned in sub-clause (a), or occupied by the person receiving the income, mentioned in sub-clauses (ii) and (iii) of clause (b). Proviso (i), however, says that such building must be on, or in the immediate vicinity of the land, and must be so connected with the land that the owner or occupier of the land requires it as his dwelling-house, or for agricultural purposes. Proviso (ii) says that the land referred to must be such as is assessed to land revenue in India, or is subject to a local rate, assessed or collected by the officers of the Government. However, where the land is not so assessed or subject to a local rate, it is a land not situated within the area of a municipality with a population of not less than 10,000 or within such distance as may be notified, not exceeding a distance of 8 kilometres from the local limits thereof.

"Income" is defined in clause (24) of section. Sub-clause (vi) of the definition says that "any capital gains chargeable u/s 45" are included within the definition of "income".

10. Now, the first and the main contention of learned counsel for the petitioners is this : Parliament's power to tax the income is derived from entry 82 in the Union List of the Seventh Schedule to the Constitution, which reads "taxes on income other than agricultural income". In other words, Parliament is not competent to levy a tax on agricultural income, which power belongs to the State Legislature alone, as provided by entry 46 in the State List, which reads "taxes on agricultural income". The expression "agricultural income" is defined in clause (1) of article 366 of the Constitution, to mean "agricultural income as defined for the purposes of the enactments relating to the Indian Income Tax Act, 1922". At the time of the framing of the Constitution, the Income Tax Act in force was the Indian Income Tax Act, 1922, but, by virtue of the General Clauses Act, the words "Indian Income Tax Act" in the said definition would now refer to the Income Tax Act, 1961, which means that the expression "agricultural income" occurring in the aforesaid entries in the Seventh Schedule should be understood in the manner, and in the sense defined by clause (1) of section 2 of the Income Tax Act. According to sub-clause (a) of the said definition in the Income Tax Act, "any..... revenue derived from land which is situated in India and is used for agricultural purposes" constitutes agricultural income. Income derived by transfer of land is also revenue derived from land, as held by the Supreme Court. If so, taxing such agricultural income is beyond the legislative competence of Parliament. No doubt, the definition of "capital asset" includes all agricultural lands situated within the limits of a municipality and a radius of 8 Kms. thereof, but the definition of "agricultural income" has not been correspondingly amended. Even today, in spite of the amendment of the definition of "agricultural income" by Taxation Laws (Amendment) Act, 1970, the income derived from agricultural land (which included income derived from sale of such land) situated within the limits of a municipality - and its 8 kilometres" radius, if notified -

continues to be agricultural income. The proviso in the said definition, even after it was substituted by the said Amendment Act, is only a proviso to sub-clause (c); the said proviso is not applicable to sub-clauses (a) and (b) of the definition. Sub-clause (c) deals only with income derived from the building connected with the land and owned/occupied by the receiver of rent or income from agricultural land. If so - it is argued - the inclusion of agricultural land situated within the municipal limits and its radius of 8 kilometres, within the definition of "capital asset" is incompetent and beyond the legislative power of Parliament. This contention, in our opinion, requires serious examination.

11. Reading entry 82 of the Union List and entry 46 of the State List, it is clear that Parliament is not competent to tax agricultural income. The expression "agricultural income" occurring in the said entries has to be understood in the manner and in the sense defined in clause (1) of section 2 of the Income Tax Act, 1961. The question is whether the profit or gain arising from the transfer of an agricultural land, is "agricultural income" within the meaning of section 2(1) of the Act, and if so, to what extent, and in what situation ? This question has to be examined under several heads. Firstly, we may take the definition of "capital asset" in section 2(14) of the Act. Until the amendment of the definition of "capital asset" by the Finance Act, 1970, "agricultural land in India" was excluded from the definition of "capital asset" by clause (iii) of the definition. However, by the Finance Act (being Act No. 19 of 1970), an exception was provided to the said sub-clause (iii). The effect of the amendment was that agricultural land situated within the limits of a municipality (by whatever name called) having a population of not less than 10,000 and within such distance as may be notified, not exceeding a distance of 8 kilometres from its limits, became a "capital asset" within the meaning of the said definition. For the purposes of this definition, it is immaterial whether the agricultural land is actually under cultivation or not. According to the definition as amended by the Finance Act (19 of 1970), all agricultural lands situate within municipalities and within such distance as may be notified, not exceeding 8 kilometres" radius, became capital assets.

12. The question then arises whether the profits and gains arising from the transfer of an agricultural land - even where it is called a capital asset - is "agricultural income" ? If it is agricultural income, Parliament cannot tax it by merely calling the agricultural land a "capital asset". Learned counsel for the petitioners contends that even the income derived from the sale of agricultural land is "revenue derived from land" within the meaning of clause (a) of the definition of "agricultural income" in section 2(1) of the Act. The contention is that if the land is used for agricultural purposes, within the meaning of the said clause in the definition, any capital gain arising from the transfer of such land would be agricultural income, and taxing it would, therefore, be beyond the competence of Parliament. Reliance is placed upon the decision of the Supreme Court in *Sevantilal Maneklal Sheth Vs. Commissioner of Income Tax (Central), Bombay*, and the decision of the Bombay High Court in *Manubhai A. Sheth and others Vs. N.D. Nirgudkar, 2nd Income Tax Officer, A-II Ward, Bombay* and

another, , in support of this proposition. Ex facie this contention appears to be extreme. To say that "consideration for land" is "income from land" is to jettison the accepted notions. But inasmuch as this argument is advanced on the basis of a decision of the Supreme Court and has been accepted by the Bombay High Court, it has to be examined carefully.

13. Capital gains were first brought to tax by introducing section 12B in the Indian Income Tax Act, 1922, by the Indian Income Tax and Excess Profits Tax (Amendment) Act (being Act No. 22 of 1947). Soon thereafter, the power of the Central Legislature to levy the tax on capital gains was questioned by certain assesseees on the ground that capital gain is not "income" within the meaning of entry 54 in List I of the Seventh Schedule to the Government of India Act, 1935 (corresponding to entry 82 in List I of the Seventh Schedule to our Constitution). The Supreme Court in *Navinchandra Mafatlal Vs. The Commissioner of Income Tax, Bombay City*, held that the restricted meaning which the expression "income" has acquired in English legislative practice need not and should not be applied while interpreting the said expression occurring in the legislative entries. The legislative heads, it was observed, must be interpreted liberally. It was also pointed out that in the United States of America and Australia, the expression "income" is understood in a wide sense so as to include capital gain. The Supreme Court referred to the observations of Lord Wright in *Raja Bahadur Kamakshya Narain Singh v. CIT* [1943] 11 ITR 513, to the effect that "income, it is true, is a word difficult and perhaps impossible to define in any precise general formula. It is a word of the broadest connotation..." and, held that capital gain is also "income" within the meaning of the said legislative entry. On that basis, the legislative competence of the Central Legislature to tax the capital gains was upheld. (The legislative entries and the definition of "agricultural income" in the 1935 Act and our Constitution are identical. Similarly, the definition of "agricultural income" in the 1922 Act was the same as in the 1961 Act; the amendment in 1970 has no relevance on this aspect). In *Sevantilal Maneklal Sheth Vs. Commissioner of Income Tax (Central), Bombay*, ; the question was whether the capital gains derived by the wife of the assessee by the sale of assets (shares) transferred to her by him can be included in the total income of the assessee u/s 16(3) (a) (iii) of the Indian Income Tax Act, 1922. The contention was that "so much of the income of a wife..... as arises directly or indirectly..... from assets....." occurring in the said provision means only the income which the asset produces while it continues to remain in the hands of the assessee and does not include the gain made by selling the asset and parting with its possession. This argument was rejected by the Supreme Court in the following words (at page 507) :

"In our opinion, there is no logical distinction between income arising from the asset transferred to the wife and arising from the sale of the assets so transferred. The profits or gains which arise from the sale of the asset would arise or spring from the asset, although the operation by which the profits or gains is made to arise out of the asset is the operation of the sale. If the asset is

employed, say by way of investment and produces income, the income arises or springs from the asset; the operation which causes the income to spring from the asset is the operation of the investment. In the operation of the investment, income is produced while the asset continues to belong to the assessee, while in the operation of a sale, gain is produced, which is still income, but in the process, the title to the asset is parted with. Although the processes involved in the two cases are different, the gain which has resulted to the owner of the asset, in each case, is the gain, which has sprung up or arisen from the asset. There is hence no warrant for the argument that the capital gain is not income arising from the assets, but it is income, which arises from a source which is different from the asset itself."

14. This decision was followed in *Manubhai A. Sheth and others Vs. N.D. Nirgudkar*, 2nd Income Tax Officer, A-II Ward, Bombay and another, by the Bombay High Court and it was held that the capital gain made on sale of agricultural land would be "revenue derived from land" within the meaning of that expression in section 2(1)(a) of the Income Tax Act. Indeed, the Bombay High Court refers to several other decisions on this aspect which we do not think it necessary to refer to, since, in our opinion, the decisions referred to above are quite adequate. Accordingly, we hold that the profit or gain resulting from sale of agricultural land is "revenue derived from land", i.e., it is agricultural income within the meaning of clause (1) in section 2 of the Act.

15. The next step is to examine whether, by virtue of the amendment of the definition of "agricultural income" by the Taxation Laws (Amendment) Act, 1970 (No. 42 of 1970), any change has been brought about in the concept of the said expression consistent with the amendment of the definition of "capital asset" by the Finance Act, 1970. In other words, what we have to see is whether the income from agricultural lands situated within municipalities with a population of not less than 10,000 and within such distance as may be specified, not exceeding 8 kilometers from their limits, has been rendered non-agricultural income. This was and is necessary for Parliament to do, in our opinion, since so long as the income from agricultural lands situated within the municipal limits, etc., is not made a non-agricultural income by amending the definition, it will continue to be "agricultural income" even for the purpose of entry 82 in List I of the Seventh Schedule and cannot be taxed by Parliament. All that was necessary for Parliament to do was to amend the said definition in the same manner as it has amended the definition of "Capital asset". It could have said that the income arising from agricultural lands situated within the municipal limits with a population of 10,000, etc., shall not be treated as agricultural income and there the matter would have ended. But, unfortunately, the exercise done by Parliament has failed to achieve the said objective - if indeed that was the objective. May be it is a case of bad draftsmanship; may be not. The result, however, is that the income from agricultural lands which are used for agricultural purposes, even though situated within the municipal limits with more than 10,000 population and within the notified limits thereof, continues to be

agricultural income.

16. Turning to the definition of "agricultural income", if one examines the unamended and amended definitions side by side, it would be clear that what we have called proviso (ii) is only an elaboration of the words "and is either assessed to land revenue in India or is subject to a local rate assessed and collected by the officers of the Government as such....", which occurred in sub-clause (a) of the unamended definition. In such a case, they should have placed proviso (ii) at the end of sub-clause (b) in which case it would have qualified the land referred to in both sub-clauses (a) and (b), as well as (c). But, instead of doing that, they made it a part of the proviso to sub-clause (c). Sub-clause (c) deals only with income of the building which is integrally connected with agricultural land and is occupied by the person in receipt of rent or revenue, or is occupied by the person carrying on the operations mentioned in clause (b). Indeed, clause (2) of section 2 of the Taxation Laws (Amendment) Act, 1970, clearly says :

"In sub-clause (c), for the proviso, the following proviso shall be, and shall be deemed always to have been, substituted, namely :-

"Provided that - ..."

17. It is thus clear that the entire proviso was meant as proviso to sub-clause (c) alone. If it is a proviso to sub-clause (c), indeed a very inconsistent and, what may be called an absurd, consequence is flowing therefrom, viz., while income from any building integrally connected with an agricultural land situated within the municipal limits, etc., is not agricultural income, the income from those very lands constitutes agricultural income. If the defect was only in the matter of placement, we could probably have got over it with a view to avoid the aforesaid absurd consequence; but, we find that the defect is more fundamental, as we shall presently point out. For the purpose of this discussion, we shall assume that proviso (ii) is a proviso to sub-clauses (a) and (b) and is not confined to clause (c). To demonstrate what we are saying, we shall set out the proviso again :

"Provided that -

(i) the building is on or in the immediate vicinity of the land, and is a building which the receiver of the rent or revenue or the cultivator, or the receiver of rent-in-kind, by reason of his connection with the land, requires as a dwelling house, or as a store-house, or other out-building, and

(ii) the land is either assessed to land revenue in India or is subject to a local rate assessed and collected by officers of the Government as such or where the land is not so assessed to land revenue or subject to a local rate, it is not situated -

(A) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee or by any other name) or a cantonment board and which has a population of not less than ten thousand

according to the last preceding census of which the relevant figures have been published before the first day of the previous year; or

(B) in any area within such distance, not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (A), as the Central Government may, having regard to the extent of, and scope for, urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette".

18. We are not concerned herein with proviso (i) for the reason that, admittedly, it is applicable only to a building connected with land. We are concerned only with proviso (ii). According to this proviso, the land referred to is either land which is assessed to land revenue in India, or is subject to a local rate assessed and collected by the officers of the Government as such, or where the land is not so assessed to land revenue or subject to a local rate, it is not situated within the limits of the municipality, etc. In other words, proviso (ii) is in two parts. If the land is assessed to land revenue in India, or is subject to a local rate assessed and collected by the officers of the Government, no further condition need be satisfied. It would be a land within the meaning of sub-clauses (a) and (b). Only where the land is not so assessed to land revenue or is subject to a local rate, is the further condition attracted, viz., that it should not be situated within the limits of municipality, etc. In other words, the exceptions mentioned as (A) and (B) in the said proviso (ii) qualify the latter part of proviso (ii) alone, and not the first part of proviso (ii). The result would be that if a land is assessed to land revenue or is subject to a local rate assessed and collected by the Government, its income would still be "agricultural income", even though the said land is situated within the limits of a municipality with a population of not less than 10,000 and within its notified limits. Only where the land is not so assessed or is subject to a local rate, does its income cease to be agricultural income, if it is situated within the said limits. We do not find it possible to read exceptions (A) and (B) as qualifying both the types of land, i.e., lands which are assessed to land revenue, etc., and lands which are not so assessed. If that were the intention of Parliament, it could have used the language employed in sub-clause (iii) of the definition of "capital asset" in section 2(14). Nothing would have been simpler than that. If the object was to say that the income from all lands (i.e., agricultural lands) situated within the limits of a municipality, etc., ceases to be agricultural income, it was not necessary to use all that language in proviso (ii). They could have simply repeated the wording of sub-clause (iii) of the definition of "capital asset" in section 2(14).

19. Thus, it is clear that if we wish to say that the income of the land assessed to land revenue, etc., situated within the limits of a municipality, etc., is not agricultural income, we have to (1) change the placement of proviso (ii); we have to place it after sub-clauses (a) and (b), and before sub-clause (c), and (2) bend and strain the language of proviso (ii), so as to read the exceptions mentioned in (A) and (B) as qualifying both the categories of land mentioned

therein. We are of the opinion that such an exercise, more so in the context of a taxing enactment, may, not be warranted, that too at the hands of the High Court.

20. The conclusion that follows from the above discussion is that Parliament could not have taxed the profits and gains arising from the transfer of a land used for agricultural purposes - whether such land is assessed to land revenue in India or is subject to a local rate assessed and collected by the officers of the Government - notwithstanding that such land is situated within the limits of a municipality, etc., with a population of not less than 10,000 or is situated within such distance as may be notified, not exceeding 8 kilometres from such municipal limits. The reason is simple - it is agricultural income. By merely treating such land as a "capital asset" within the meaning of section 2(14), Parliament does not get the competence to tax it. The income arising from its transfer is still agricultural income for the reasons stated above. Indeed, it must be held that Parliament never intended to tax such income. (Of course, the position with reference to the income from the building connected with the land situated within the limits of a municipality, etc., is different; it would not be agricultural income).

21. In the above situation, there is no occasion to strike down any portion of the definition of "capital asset". We have arrived at the above conclusion by reading the definitions of "capital asset" and "agricultural income", in clauses (14) and (1) of section 2 together. We are also of the opinion that, if necessary, we can employ the theory of "reading down" in such a situation, as has been done by the Bombay High Court in *Manubhai A. Sheth and others Vs. N.D. Nirgudkar, 2nd Income Tax Officer, A-II Ward, Bombay and another*, . The conclusion arrived at by the Bombay High Court is more or less on the same lines as ours.

22. We may now refer to the decisions of the Gujarat, Karnataka and Kerala High Courts on this point, which have taken a contrary view. In *Ambalal Maganlal Vs. Union of India and Another*, , the approach of the Gujarat High Court is that by virtue of the amendment of the definition of "capital asset" by the Finance Act, 1970, all agricultural lands situated within the limits of municipalities, etc., cease to be agricultural lands. Dealing with the argument advanced with reference to the amendment of the definition of "agricultural income" in section 2(1), the Bench disposed of the matter in the following words (at pages 247 and 248) :

"With effect from April 1, 1970, the definition of "agricultural income" was amended by the Taxation Laws (Amendment) Act, being Act No. 42 of 1970, with retrospective effect, that is, from April 1, 1970, so as to provide by virtue of the proviso that agricultural income must not be derived from land situated in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal Corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the

first day of the previous year, or in any area within such distance, not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in the earlier item as the Central Government may, having regard to the extent of, and scope for, urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette. Thus income derived from any such land as is referred to in the proviso, clause (ii), sub-clauses (A) and (B) of section 2(1) is not "agricultural income" and, therefore, for the purposes of article 366 (1) and hence for the purposes of entries in the Seventh Schedule, income derived from such lands is also not agricultural income. It is in the light of this definition of "agricultural income" which came into force with effect from April 1, 1970, that one has to consider the submissions made regarding the legislative competence of Parliament to enact section 2(14) of the Income Tax Act, 1961."

23. Firstly, the retrospective effect given to the definition of "agricultural income" in section 2(1) is not from April 1, 1970, but with effect from April 1, 1962, i.e., the date of commencement of the Income Tax Act, 1961. Secondly, the defect in the language of the said definition, pointed out by us above, does not appear to have been specifically brought to the notice of the learned judges. It is for this reason that the Bombay High Court has dissented from this opinion in *Manubhai A. Sheth and others Vs. N.D. Nirgudkar, 2nd Income Tax Officer, A-II Ward, Bombay and another*, .

24. The Karnataka High Court in *B.S. Jayachandra Vs. Income Tax Officer and Another*, , followed the approach of the Gujarat High Court, dissenting from the Bombay view. The Karnataka High Court has referred in extenso to two circulars issued by the Central Board of Direct Taxes, being Circular No. 56 dated March 19, 1971, and Circular No. 45, dated September 2, 1970 [1971] 79 ITR 33, which we shall refer to presently.

25. The approach adopted by the Kerala High Court in *Commissioner of Income Tax Vs. T.K. Sarala Devi*, is altogether different. According to it, the income derived by sale of agricultural land is not agricultural income; it would be agricultural income only where it is derived by use of land, but not by sale of land. Reference was made to the definition of "income" in clause (24) of section 2 of the Act, according to which "income" includes capital gains chargeable u/s 45. It was held that profits or gains arising from the sale of agricultural land, not being agricultural income, is amenable to taxation by Parliament under entry 82 in List I of the Seventh Schedule.

26. We may at this stage refer to Circular No. 56 dated March 19, 1971, issued by the Central Board of Direct Taxes, which has been extracted in the judgment of the Karnataka High Court in *B.S. Jayachandra Vs. Income Tax Officer and Another*, . The circular explains the meaning and purpose behind the amendment of the definition of "agricultural income" in section 2(1) of the Act. After setting out the unamended definition, the circular states as follows (at page 196) :

"92. In recent years, agricultural operations have been extended to lands in terai areas or cantonments, forest lands, etc., where the land is not assessed to land revenue and is not subject to any local rate as required under the above-mentioned definition of agricultural income. Accordingly, income derived by agricultural operations on such lands is presently outside the scope of "agricultural income" and becomes liable to central Income Tax. Apart from this, in several States, lands up to specified limits have been exempted from land revenue assessment. Hence, income derived by the performance of agricultural operations on such land in these States would also come within the purview of central income taxation.

93. As the character of the income derived by agricultural operations remains the same whether or not the land is subject to Central Income Tax such income in those such income in those cases where there is no land revenue assessment while exempting income of the same nature in other cases. With a view to removing this anomaly and providing tax relief to the agriculturists who cultivate forest lands, lands in terai areas or cantonments or in States which have abolished land revenue on small holdings, the definition of "agricultural income" in clause (1) of section 2 has been amended so as to drop the condition that the land from which the income is derived should be assessed to land revenue or any local rate. This change will bring within the purview of the expression "agricultural income", income derived from cultivation of forest lands, lands in terai areas and cantonments as also lands in respect of which the State Government does not levy any land revenue.

94. In regard to income attributable to farm buildings, the amended definition of "agricultural income" provides that income attributable to such a building will be treated as agricultural income subject to the condition that the building is situated on, or in the immediate vicinity of, land which (though not assessed to land revenue or any local rate) is situated outside "urban areas", i.e., any area which is comprised within the jurisdiction of any municipality or cantonment board having a population of not less than ten thousand persons (according to the last preceding census of which the relevant figures have been published before the first day of the previous year) or within such distance (up to a maximum of eight kilometres) from the limits of any such municipality or cantonment board as the Central Government may notify in the Official Gazette. Such notification is to be issued by the Central Government only where it is satisfied that the pace of urbanisation outside any such municipality or cantonment board justifies the treatment of such areas as "urban areas". The effect of this modification will be that income attributable to farm houses situated in such "urban areas" will not be treated as agricultural income unless the land on which the farm house is situated is assessed to land revenue or any local rate. However, in the case of farm houses situated in "rural areas", i.e., any area which is outside the jurisdiction of any municipality or cantonment board having a population of not less than ten thousand persons and also beyond the notified distance outside the limits of any such municipality or cantonment board, the

income will be treated as agricultural income even where the land on which the farm house is situated is not assessed to land revenue or any local rate. For the purpose of this definition, municipality will include a municipal corporation, notified area committee, town area committee, town committee or other similar authority by whatever name called, e.g., "Nagar Nigam".

95. The amendment of the definition of agricultural income, as explained in the preceding paragraphs, is retrospective and is deemed to have taken effect from April 1, 1962, i.e., the date on which the Income Tax Act came into force. Accordingly, where income derived by agricultural operations on land which is not assessed to land revenue or any local rate has been subjected to Central Income Tax, the relevant assessment should now be rectified and the tax charged on such income refunded or remitted, as the case may be. Where assessment proceedings have been initiated for bringing such income to tax, these should be dropped."

27. We may also refer to the other circular referred to in the judgment of the Karnataka High Court, i.e., Circular No. 45, dated September 2, 1970, explaining the meaning and object behind the amendment of the definition of "capital asset" in section 2(14). It reads thus (at p. 199) :

"29. Capital gains arising from the transfer of a capital asset have been chargeable to Income Tax for several years past. Where the transfer of the capital asset is effected within a period of 24 months from the date of its acquisition by the assessee, the capital gain is treated on a par with ordinary income and charged to tax on that basis. Gains arising from the transfer of a capital asset held by the assessee for more than 24 months are charged to tax on a concessional basis. In the case of companies, such gains are taxed at the rate of 40% where they relate to lands and buildings, and at 30% where they relate to other assets. In the case of non-corporate taxpayers, only a certain portion of the capital gains in excess of Rs. 5,000 is included in the taxable income. This proportion is 55% where the gains relate to lands and buildings and 35% where they relate to other assets.

30. Prior to the amendment made by the Finance Act, 1970, the definition of the term "capital asset" in section 2(14) of the Income Tax Act, 1961, excluded from its scope, inter alia, agricultural land in India. Accordingly, no liability to tax arose on gains derived from transfer of agricultural land in India. This exemption of agricultural land from the scope of levy of tax on capital gains has a historical origin and is not due to any bar in the Constitution or the competence of Parliament to legislate for such levy. Agricultural land situated in municipal and other urban areas is essentially similar to non-agricultural land in such areas in its potentialities for use due to the progress of urbanisation and industrialisation. The Finance Act, 1970, has accordingly amended the relevant provisions of the Income Tax Act so as to bring within the scope of taxation capital gains arising from the transfer of agricultural land situated in certain areas. For this purpose, the definition of the term "capital asset" in section 2(14) of the Income Tax Act

has been amended so as to exclude from its scope only agricultural land in India which is not situate in any area comprised within the jurisdiction of a municipality or cantonment board and which has a population of not less than ten thousand persons according to the last preceding census for which the relevant figures have been published before the first day of the previous year. The Central Government has been authorised to notify in the Official Gazette any area outside the limits of any municipality or cantonment board having a population of not less than ten thousand, up to a maximum distance of eight kilometres from such limits, for the purposes of this provision. Such notification will be issued by the Central Government having regard to the extent of, and scope for, urbanisation of such area, and, when any such area is notified by the Central Government, agricultural land situated within such area will stand included within the term "capital asset". Agricultural land situated in rural areas, i.e., areas outside any municipality or cantonment board having a population of not less than ten thousand and also beyond the distance notified by the Central Government from the limits of any such municipality or cantonment board, will continue to be excluded from the term "capital asset".

31. The amendment to section 2(14), as stated in the preceding paragraph, applies from 1st April, 1970, i.e., for and from the assessment year 1970-71. However, by an amendment to section 47 of the Income Tax Act, it has been specifically provided that no capital gain or loss will be computed with reference to any transfer of agricultural land in India effected before 1st March, 1970.

32. The effect of the amendments to section 2(14) and section 47, as stated above, will be that capital gains arising from transfer of agricultural lands situated in the municipal and other urban areas on or after 1st March, 1970, will become liable to taxation even where such land was held for bona fide agricultural purposes, often as the main source of livelihood. With a view to relieving the burden of taxation on the capital gains in such cases, a provision has been made, in a new section 54B of the Income Tax Act, for exempting from tax the capital gain arising from the transfer of agricultural land in certain circumstances. Under the new section 54B, where the capital gain arises from transfer of land which in the two years immediately preceding the date of transfer was being used by the assessee or a parent of his for agricultural purposes, and the assessee has, within a period of two years after that date purchased any other land (whether in the same area or elsewhere) for being used for agricultural purposes, then the capital gain will not be charged to tax to the extent that it has been utilised for acquiring the fresh land. Where the amount of the capital gain exceeds the cost of acquisition of the fresh land, only the excess will be chargeable to tax. The concession will, however, be forfeited if the assessee transfers the fresh land acquired by him within a period of three years from the date of its purchase....."

28. A perusal of the two circulars indicates - if they can be taken as reflecting the intention of Parliament - that for taxing the capital gains arising from agricultural

lands situated within municipalities, etc., Parliament thought that it would be sufficient to amend the definition of "capital asset" - and that was done by the Finance Act, 1970 (No. 19 of 1970). The amendment of the definition "agricultural income" was altogether for a different purpose, as is clearly set out in the circular. But, as we have pointed out, the mere amendment of the definition of "capital asset" is not sufficient to clothe Parliament with the power to tax agricultural income. For that purpose, the definition of "agricultural income" itself had to be amended, which would then have reflected back into entry 82 of List I.

29. In this view of the matter, it is not necessary for us to consider the attack on the basis of art. 14.

30. For the above reasons, we allow W. P. No. 2592 of 1981 and hold that the profits and gains arising from the transfer of the lands concerned in this writ petition could not have been brought to tax under the provisions of the Income Tax Act, 1961.

31. So far as the other writ petitions are concerned, there is no specific allegation that the lands concerned therein were being used for agricultural purposes. The leviability of the capital gains tax depends upon the said circumstance. In the absence of a clear allegation in the writ petitions, we leave the matter for verification by the concerned Income Tax Officer. He shall verify whether, at the time of transfer, the land was being used for agricultural purposes. If it was so used, the income arising from the transfer of such land would be "agricultural income" and not exigible to capital gains tax. Otherwise, the levy would be proper. The expression "agricultural purposes" has to be understood in its ordinary connotation. It includes the activities of the nature mentioned in paras (ii) and (iii) of sub-clause (b) of clause (1) of section 2 (definition of "agricultural income").

32. Writ Petitions Nos. 9605 of 1981, 5641 of 1980, 1605 of 1986, 2211 of 1986, 2123 of 1986 and 7167 of 1982 are disposed of with the above directions.

33. There shall be no order as to costs.

34. Advocate's fee Rs. 100 in each.

35. We wish to place on record the valuable assistance rendered ably by Sarvasri Y. Ratnakar and S. R. Ashok for the petitioners, and Sri M. Suryanarayana Murthy, for the Revenue.