A.B.C. Vs. Third Income-tax Officer

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Oct-22-1981

Reported in : (1982)1ITD724(Mum.)

Judge : K Thakore, K Menon

Appellant : A.B.C.

Respondent : Third Income-tax Officer

Judgement :

2. The assessee became the tenant of a shop room even prior to 1-1-1954. There were other shop rooms/flats also in the building.

Towards the close of 1969, the tenants of the building alongwith the landlord decided to form a co-operative society of all the tenants. The society was incorporated on 18-4-1970. The tenants agreed to pay a sum of Rs. 4,81,000 to the landlord for acquiring his ownership rights and also to spend a sum of Rs. 3,35,000 for the repairs of the building.

The share of the assessee in these came to Rs. 40,661. The landlord sold his ownership rights to the society on 27-10-1970. On 16-2-1975, the assessee sold his shop room to another for Rs. 4,11,000. This was inclusive of the furniture and telephone in the premises, which were valued at Rs. 9,649 and also of 5 shares in the co-operative society valued at Rs. 250. Thus, the sale price of the shop premises came to Rs. 4,01,101. The assessee contended that the sale related to two separate rights, namely, the tenancy rights and the ownership rights, and that while the capital gains, if any, in respect of the tenancy rights will be long-term capital gains, those in respect of the ownership alone will be short-term capital gains. The ITO held that the tenancy rights of the assessee had merged totally in the ownership rights, that the two became inseparable and that it is the ownership right which was acquired by the assessee within 60 months of the sale, the surplus arising out of the sale has to be treated as short-term capital gains. He, therefore, deducted from Rs. 4,11,000 the sum of Rs. 40,600 as cost of acquisition and treated the balance amount of Rs. 3,70,400 as short-term capital gains.

3. The appeal by the assessee before the Commissioner (Appeals) was not successful. The Commissioner (Appeals) held that the right of the assessee cannot be split up into two, that under Section 6 of the Transfer of Property Act, the occupancy right of a tenant cannot be transferred, that what was transferred was the ownership right and that the same cannot be split up into short-term capital gains and long-term capital gains. The Commissioner (Appeals), however, directed the ITO to recompute the short-term capital gain after taking into consideration the cost of furniture,

telephone, etc., which the ITO had omitted to do.

4. The grounds taken in the appeal are as follows : The Commissioner (Appeals) erred in rejecting the contention of the assessee that the cost of the rights of the assessee in the premises should be computed at the sum of Rs. 44,600 as increased by the tenancy value of the premises as on the date of the formation of the society. On the formation of the society, there was merely an improvement in the interest of the assessee in the premises and the nature of the interest of the assessee continued to remain the same as before. The interest of the assessee as on 1-1-1954 was increased by only Rs. 44,600, being the payment made to the promoters of the society. The interest of the assessee was being held for more than 5 years and the gain was a long-term capital gain. The consideration received by the assessee for the transfer was for the right title and interest in the premises, which was only tenancy right, and for the membership rights in the society. The cost of acquisition of the tenancy value was nil and the portion of the consideration for the sale which is attributable to the tenancy rights was not liable to tax. If it is found to be taxable, it can be taxed only as a long-term capital gain and the surplus realised on the transfer of the membership rights in the society alone constituted short-term capital gain.

5. It was first contended by Shri Dastur, the learned counsel for the assessee, that in the present case the tenancy right had not cost anything to the assessee, that the amount of Rs. 40,661 paid by the assessee to the co-operative society can be treated only as a contribution to the society, that the cost of the acquisition of the rights of the assessee is, therefore, totally indeterminable and that the provisions relating to capital gains in Section 45 are not attracted to the transactions at all. In support of this proposition, the learned counsel for the assessee relied upon the ruling of the Supreme Court in CIT v. B.C. Srinivasa Setty [1981] 128 ITR 295, wherein it has been held that none of the provisions pertaining to the head "Capital gains" suggest that they include an asset for the acquisition of which no cost can be conceived. We are unable to accept the contention that the cost of acquisition with regard to no portion of the rights of the assessee is determinable. It is not also possible to accept the contention that the payment made by the assessee to the co-operative society is in the form of a contribution. As stated earlier, this payment represents the contribution of the assessee for acquiring the rights of the landlord and for effecting certain repairs to the building. This payment is clearly traceable to the acquisition of the ownership rights by the assessee. The order of the ITO shows that before him even the assessee had split up his tenancy rights and ownership rights and had claimed that the gains in respect of the sale should be treated as long-term and short-term capital gains, respectively. We, therefore, reject the contention that the provisions relating to capital gains are not attracted to the transaction at all.

6. The next and the alternative contention of the learned counsel for the assessee was that in any case the sale consideration obtained by the assessee should be apportioned between his tenancy rights and his ownership rights and that the capital gains, if any, with regard to each transaction should be separately ascertained and assessed. It may be that from a purely technical point of view, there might have been a merger of the ownership rights and tenancy rights resulting in the extinguishment of the tenancy rights. But it appears to us that when one has to determine the cost of acquisition of the rights of the assessee, one can not ignore the fact that the assessee had two distinct rights, namely, the tenancy rights and the ownership rights.

It is also clear that the sale consideration realised by the assessee is not relatable

solely to the ownership rights of the assessee, because a sale of the ownership rights would not have secured this amount of consideration. A substantial portion of the consideration is traceable to the occupancy-rights of the assessee. The amount of Rs. 40,661 paid by the assessee to the society is, as already stated, for the acquisition of the ownership rights only. (Although this includes the assessee's share of the cost of the repairs, this payment has been treated as payment for the acquisition of the ownership.).

7. At a stage, it was also contended by the learned counsel for the assessee that even after the acquisition of the ownership rights by the co-operative society, the assessee continued to be a tenant because the ownership rights vested in the society and not in the assessee. In this connection, reliance was also placed on the standard bye-laws for the Flat Owners Co-operative Society, a copy of which was made available.

The changes, if any, made in these bye-laws while adopting the same for the co-operative society of the present building are not indicated. But it will be clear from the standard by-laws that the assessee cannot be equated to a tenant and the society to a landlord. The concept of ownership flats and the role of the co-operative society in managing the flats is well established and well-known. It may be that certain restrictions have been imposed on the occupants of the flats and they cannot sell away the flats as in the case of an absolute owner. But, once the flat is transferred with the permission of the society and the shares held by the owner of the flat in the society are also transferred, it has to be treated for all practical purposes as a transfer of the full rights in an owership flat and the same cannot be treated as the transfer of mere occupancy right.

8. But we are of the view that it will not be correct to assess the capital gains by substracting from the sale price the amount paid by the assessee for acquiring the rights of the landlord. As already stated, a substantial portion of the sale price is attributable to the occupancy rights of the assessee and it will not be proper to treat the difference between the amount paid to the landlord and the sale price as capital gains on the ownership right. That portion of the sale price, which relates to the occupancy right, is traceable to the tenancy right which the assessee had originally. We are, therefore, of the view that the proper course is to apportion the sale price between the ownership right and the occupancy right taking into consideration the conditions prevalent in the city at the relevant time and to work out the capital gains with respect to the two rights separately. It will not also be proper to accept it straightaway that the assessee had incurred no cost for the acquisition of the tenancy right because the matter has not been examined either by the ITO or the Commissioner (Appeals). If it is found that the tenancy right was acquired without incurring any cost, no capital gains will be attracted with regard to that portion of the sale price which is relatable to the occupancy right in view of the decision of the Supreme Court referred to earlier.

In any case, the capital gains with regard to the ownership right can be worked out as admittedly it has been acquired at a cost. It is also clear that the capital gains, if any, with regard to the occupancy right, will be long-term capital gains while that with regard to ownership right will be a short-term capital gain. As the necessary materials for working out the matter in the light of what is stated above are not available, the matter will be restored to the Commissioner (Appeals) for the limited purpose mentioned above.

9. In the result, the order of the Commissioner (Appeals) with regard to the matter raised in the present appeals is set aside and it is restored to him for fresh disposal according to law and in the light of the observations above. The appeal will be treated as allowed for statistical purposes.