(1996) 02 KL CK 0055

High Court Of Kerala

Case No: Income-tax Reference No. 519 of 1985

Smt. K. Sarala Devi		APPELLANT
	Vs	
Commissioner of Income Tax		RESPONDENT

Date of Decision: Feb. 29, 1996

Acts Referred:

- Income Tax Act, 1961 - Section 45, 48, 54E, 55(2)

Citation: (1996) 132 CTR 464 : (1996) 222 ITR 211

Hon'ble Judges: K.S. Radhakrishnan, J; K.K. Usha, J

Bench: Division Bench

Advocate: C. Kochunni Nair, for the Appellant; P.K.R. Menon and N.R.K. Nair, for the Respondent

Judgement

K.K. Usha, J.

The Cochin Bench of the Income Tax Appellate Tribunal has referred for the opinion of this court u/s 256(1) of the Income Tax Act, 1961, the following questions of law arising out of the order of the Tribunal dated August 31, 1984, in I. T. A. No. 920/(Coch) of 1983 :

"1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding" that for the purpose of working out the capital gains u/s 48 of the Income Tax Act, 1961, the consideration received by the assessee and other co-owners by the sale of the property measuring 4 acres 83 cents should be taken as Rs. 6,20,000 and that there was no diversion by overriding title in respect of Rs. 4,44,374 which was paid by the purchaser to the Income Tax Department in satisfaction of the Income Tax liabilities of the father of the assessee, from whom the property was inherited by the assessee and the other co-owners ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the abovesaid amount of Rs. 4,44,374 paid to the Income Tax Department cannot be treated as the cost of acquisition of the capital assets ?

3. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the assessee was not entitled to exemption u/s 54E of the Act, 1961, in respect of the deposits made by the assessee ?

4. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the Commissioner of Income Tax (Appeals) was justified in not entertaining an additional ground taken by the assessee for the first time before the Commissioner of Income Tax (Appeals) that the property sold was agricultural land and that the sale of the property did not, therefore, attract tax on capital gains ?"

The reference relates to the Income Tax assessment for the year 1977-78 for which the previous year ended on March 31, 1977. The father of the assessee, the late Kesavan, was the owner of 4 acres and 86-3/4 cents of land situated outside the Quilon Municipality limits. On his death, the property devolved on the assessee, her brother and her sister and they came into joint possession under partition deed dated February 14, 1964. The property was under attachment of the Income Tax Department for arrears of Income Tax due from the late Kesavan even during his lifetime. While the attachment was thus in force, on March 17, 1977, the assessee, her brother and her sister along with her mother sold the property to the Kerala State Warehousing Corporation for a consideration of Rs. 6,20,000. As per the terms of the document an amount of Rs. 1,99,681.04 had to be paid by the vendee to the Department for and on behalf of the vendors. A further sum of Rs. 2,44,693.40 was reserved with the purchaser for payment to the Income Tax Department towards interest if any when it is finally held to be due by the Central Board of Direct Taxes. In case no amount was found due, the amount thus reserved has to be paid to the vendors within one month after the decision of the Central Board. The balance amount of Rs. 1,75,625.56 was to be paid to the vendors on or before October 30, 1977, with interest at 12 per cent. per annum.
2. The fair market value of the property as on January 1, 1954, as opted for by the assessee was determined by the Income Tax Officer at Rs. 1,50,000 for the purpose of working out capital gains u/s 55(2). Before the Income Tax Officer, the assessee contended that only the amount of Rs. 1,75,626 should be treated as having been received as consideration for the sale of the land as the balance amount was paid to the Income Tax Department pursuant to the attachment of the properties by the Department. This contention was not accepted by the Income Tax Officer. Consideration received for the sale of the property was fixed at Rs. 6,20,000. This finding was affirmed by the Commissioner of Income Tax (Appeals) as also the Tribunal.

3. The contention raised by the assessee claiming exemption u/s 54E on the basis of the deposits of sale consideration made by the assessee in May, 1978, and in February, 1979, were also rejected on the ground that the deposit was not made within six months of the transfer of the capital asset. This finding was also affirmed both by the Commissioner of Income Tax (Appeals) as well as the Tribunal. Before

the Commissioner of Income Tax (Appeals), the assessee took up a fresh contention by way of an additional ground that the property sold was agricultural land and, therefore, the transaction did not attract tax on capital gains. The contention was that the property was situated outside Quilon Municipal limits more than 8 k.m. away in a locality where the population was below 10,000. Coconut trees and other trees were planted and also seasonal crops like plantain and tapioca were being cultivated on the property. It was only a small portion of about one acre that was used for cashew factory. Reliance was placed on a certificate issued by the Village Officer to show that the property was agricultural land. The Commissioner of Income Tax (Appeals) declined to entertain the contention as the same has not been advanced before the Income Tax Officer and as the required particulars for deciding the issue were not on record. In support of the above finding the decision in The Additional Commissioner of Income Tax, Gujarat Vs. Gurjargravures Private Ltd., was relied on. Before the Tribunal, the assessee contended that the description of the property in the schedule on the sale deed itself would show that there were trees, wells, etc., in the property, thereby bringing it under the category of agricultural land. The Tribunal was not inclined to accept the contention. It took the view that the description in the document mentioned in a routine manner need not show the real character of the property. The claim of the assessee could be decided only after a detailed investigation with regard to the nature of the property and nature of the agricultural operations carried on. It cannot be decided merely on the basis of a certificate from the Village Officer produced before the Commissioner of Income Tax (Appeals).

4. On the first question, it is contended on behalf of the assessee that the Tribunal had failed to apply the principle laid down by the Supreme Court in The Commissioner of Income Tax, Bombay City II Vs. Shri Sitaldas Tirathdas, . The property originally belonged to the father of the assessee. Admittedly, during his lifetime demand had been raised against him towards Income Tax liabilities and the properties were under attachment. On the death of their father, what was obtained by the assessee and other legal heirs was property subject to the claim of the Income Tax Department. It was under these circumstances when the property was sold on March 17, 1977, that the vendee was directed to pay part of the consideration directly to the Income Tax Department towards the tax liability of their late father.

5. According to the assessee, the rules relating to attachment and sale of immovable properties to satisfy the liability to the Income Tax Department would support her contention. Rule 4 in Part I of the Second Schedule providing the procedure for the recovery of tax, lays down the mode of recoveries. One method is by attachment and sale of the defaulter''s immovable property. Rule 8 provides as to how the proceeds of execution shall be disposed of. After satisfying the costs incurred by the Income Tax Officer, the amount due under the certificate in execution were to be realised and any other amount recoverable under the Act and due upon the date on

which assets were realised. The balance if any remaining shall be paid to the defaulter. Rule 16 provides that any transaction in respect of the property under attachment can be made only with the permission of the Tax Recovery Officer, Even a civil court cannot issue any process against such property in execution of a decree for payment of money. Any private transfer contrary to the attachment shall be avoided as against the claims enforceable under the attachment. Rule 48 provides the mode of attachment of immovable property. It shall be made by an order prohibiting the defaulter from transferring or charging the property in any way and prohibiting all persons from taking any benefit under such transfer or charge. Rule 52 authorises the Tax Recovery Officer to direct sale of any immovable property which had been attached or such portion thereof as may seem necessary to satisfy the certificate. It is contended on behalf of the assessee that an attachment of the immovable property made under the above provisions created a statutory obligation on the property. Therefore, the payment made to the Income Tax Department out of the sale consideration would be diversion of the amount by overriding title and only the balance which came to the hands of the assessee can be brought to tax. According to the assessee, the claim of the Income Tax Department on the property is higher than a charge. The Department can have the property sold even without having recourse to a suit.

6. On the other hand, the Revenue submitted that Income Tax is not a charge on the property unlike wealth-tax and that attachment does not confer any charge on the property. It produces only a priority claim against unsecured creditors. Such attachment as provided under Schedule II will not come within the definition of charge u/s 100 of the Transfer of Property Act. Reliance was placed on Builders Supply Corporation Vs. The Union of India (UOI) Represented by the Commissioner of Income Tax, West Bengal and Others, and State Bank of Bikaner and Jaipur Vs. National Iron and Steel Rolling Corporation and Others, by the Revenue in support of their contention.

7. The assessee as well as the Revenue relied on The Commissioner of Income Tax, Bombay City II Vs. Shri Sitaldas Tirathdas, , in support of their respective arguments. In the above case, the assessee while computing his total income for the purpose of Income Tax sought to deduct the amount paid by him as maintenance to his wife and children under a decree of court passed by consent in a suit. No charge on property was created, still the assessee relied on a decision of the Privy Council in Raja Bejoy Singh Dudhuria v. CIT [1933] 1 ITR 135, and claimed deduction, u/s 9(1)(iv) of the Income Tax Act. This claim of the petitioner was disallowed by the Department as also the Income Tax Appellate Tribunal. But the High Court took the view that the income of the assessee to the extent of the decree must be taken to have been diverted to the wife and children, and never became income in the hands of the assessee. The Supreme Court on an appeal by the Commissioner of Income Tax disagreed with the High Court. After referring to decisions of the Privy Council as well as decisions of the High Courts the principle was stated as follows (page 374)

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"In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible ; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one''s own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable."

On the facts of the case, the Supreme Court held that no overriding charge had existed either upon the property or upon his income and, therefore, the assessee was not entitled to deduct the amount paid towards satisfaction of the decree for maintenance. It was a case where the wife and children of the assessee continued to be members of the family and received a portion of the income of the assessee after the assessee had received the income as his own. In Raja Bejoy Singh Dudhuria''s case [1933] 1 ITR 135, the step-mother of the Raja had brought a suit for maintenance and a compromise decree was passed under which the step-mother was to be paid Rs. 1,100 per month, which amount was declared a charge upon the properties in the hands of the Raja, by the court. The claim put forward by the Raja for deducting this amount from his assessable income was upheld by the Privy Council, by observing as follows (at page 138) :

"When the Act by Section 3 subjects to charge ''all income'' of an individual, it is what reaches the individual as income which it is intended to charge. In the present case the decree of the court by charging the appellant''s whole resources with a specific payment to his step-mother has to the extent diverted his income from him and has directed it to his step-mother ; to that extent what he receives for her is not his income. It is not a case of application by the appellant of part of his income in a particular way, it is rather the allocation of a sum out of his revenue before it becomes income in his hands."

The principles evolved in the above decisions were quoted and reaffirmed in Moti Lal Chhadami Lal Jain Vs. Commissioner of Income Tax, Delhi, . After referring to the decision of The Commissioner of Income Tax, Bombay City II Vs. Shri Sitaldas Tirathdas, , it was observed as follows (at page 10) :

"In the above passage, it is clear that the expressions ''reaches the assessee'' and ''has been received'' have been used not in the mense of the income being received in cash by one person or another. What the passage emphasises is the nature of the obligation by reason of which the income becomes payable to a person other than the one entitled to it. Where the obligation flows out of an antecedent and independent title in the former (such as, for example, the rights of dependants to maintenance or of coparceners on partition, or rights under a statutory provision or an obligation imposed by a third party and the like), it effectively slices away a part of the corpus of the right of the latter to receive the entire income and so it would be a case of diversion. On the other hand, where the obligation is self-imposed or gratuitous (as here), it is only a case of an application of income."

On the facts of the case, it was held that when an amount of Rs. 10,000 was to be paid to the college from the rent due from the company pursuant to an agreement between the company and the assessee it is only a mode of application of the income by the family which will make no difference to its liability to pay tax on the entire rent received. On the other hand, pursuant to a subsequent trust deed making clear the unequivocal intention of the karta to utilise the income from the properties in the manner set out in the deed of trust, the assessee-family''s full ownership of the properties got restricted and it created an overriding title in the beneficiaries to require that the income from the properties which were made the subject-matter of the trust be utilised in the manner set out therein and, therefore, the income from the properties could not be assessed in the hands of the family.

8. As mentioned earlier, the Revenue also relied on The Commissioner of Income Tax, Bombay City II Vs. Shri Sitaldas Tirathdas, and contended that by applying the principles laid down in the above decision it has to be held in the present case that application of a portion of the sale consideration by the assessee towards Income Tax liability of her late father cannot be treated as the amount which has to be diverted due to overriding title. According to the Revenue, no charge is created on the property as a result of the Income Tax liability of the assessee''s father. The only privilege is that the Union of India was entitled to claim priority in the matter of arrears of tax over other debts including decretal debts. Reference was made in this connection to Builders Supply Corporation Vs. The Union of India (UOI) Represented by the Commissioner of Income Tax, West Bengal and Others, . Learned counsel appearing on behalf of the Revenue contended that unlike the provisions contained u/s 11AAAA of the Rajasthan Sales Tax Act, 1954, there is no provision under the Income Tax Act by which the Income Tax liability is created as first charge on the property of the assessee. Reference was made to State Bank of Bikaner and Jaipur Vs. National Iron and Steel Rolling Corporation and Others, . We find that the latter two decisions relied on by the Revenue have no application in the facts of this case. In Builders Supply Corporation Vs. The Union of India (UOI) Represented by the Commissioner of Income Tax, West Bengal and Others, , the question which arose was whether the common law doctrine of the priority of Crown debts which had

been given judicial recognition in India prior to 1950 in regard to the recovery of tax dues would survive after the coming into force of the Constitution of India and also whether the provisions contained u/s 46(2) of the Indian Income Tax Act, 1922, would displace the application of the doctrine of priority of tax dues. The effect of an attachment on the property of the assessee and whether it would amount to an overriding title were not the subject-matter of consideration in the above decision. In State Bank of Bikaner and Jaipur Vs. National Iron and Steel Rolling Corporation and Others, , by way of an amendment in Section 11 of the Rajasthan Sales Tax Act, 1954, a first charge was created on the property of an assessee for sales tax dues. The question that arose for consideration was whether the first charge thus created by Section 11AAAA of the Rajasthan Sales Tax Act would operate on the entire property of the dealer including the interest of the mortgage therein. It was held that the first charge thus created over the property will have precedence even over an existing mortgage. There also the question relevant for the present case was not considered.

9. Yet another decision relied on by the .Revenue was K.V. Idiculla Vs. Commissioner of Income Tax, . One of the questions decided in the above case was whether a debt to be discharged from the assets obtained under a will can be treated as an amount diverted by overriding title and deductible in computing capital gains. The assessee obtained house property under a will executed by his father which contained a clause that certain amounts due to the assessee''s wife from the testator should be paid out of the property bequeathed. After the death of the assessee''s father, the assessee transferred the property to his wife and in his returns he claimed the amount of debt due to his wife which was discharged by him as per the directions in the will as deduction for the purpose of computation of income for capital gains. Referring to The Commissioner of Income Tax, Bombay City II Vs. Shri Sitaldas Tirathdas, , this court took the view that the obligation to discharge the debt due to the assessee''s wife was self-imposed. There was no case that the assessee''s wife had sought any charge on the property for the amount due to her. The payment of debt was nut made by virtue of any overriding obligation to make such payment. But it was made to discharge an obligation created by the testator himself in favour of his daughter-in-law. Therefore, it cannot be taken as diversion at the source before it reached the assessee.

10. What we have to consider in this case is whether going by the dictum laid down in The Commissioner of Income Tax, Bombay City II Vs. Shri Sitaldas Tirathdas, and affirmed in The Additional Commissioner of Income Tax, Gujarat Vs. Gurjargravures Private Ltd., , the attachment of the property even during the lifetime of the assessee''s father would create an overriding title. Whether the Income Tax liability was satisfied after the income was received by the assessee or before it came to her hands. Admittedly, the attachment of the property for recovery of arrears due from the assessee''s father occurred during his lifetime itself. We have already referred in detail to the relevant provisions under the rules providing the procedure for

recovery of tax including attachment of immovable property of the assessee. Rule 15 and Rule 52 would clearly show that on attachment of the property of the defaulter a charge or an obligation is created on the property to satisfy the tax liability. On the death of the assessee''s father the property devolved on the assessee. But the death of the assessee''s father would not free the property from the abovementioned charge or obligation. The assessee inherits the property subject to the charge created by way of an attachment. Therefore, when part of the sale consideration was directly paid by the vendee to the Income Tax Department to satisfy the tax liability of the assessee''s late father it cannot be taken that payment was made by the assessee after the income has reached her hands. This is not a case where the testator created a self-imposed or gratuitous obligation as in the case of K.V. Idiculla Vs. Commissioner of Income Tax, . Here in the present case the property devolved with the statutory liability in view of the attachment made by the Income Tax Department during the lifetime of the father of the assessee. The dictum laid down by the Privy Council in Raja Bejoy Singh Dudhuria''s case [1933] 1 ITR 135, is directly applicable to the facts of the present case. To that extent of the liability of the deceased father of the assessee, the income is diverted from the assessee and it is directed to the Income Tax Department. To that extent the sale consideration was not received by the assessee as her income.

11. Going by the provisions contained under Rule 8; the assessee will be entitled to receive only the balance after satisfying the Income Tax liability of her late father. In view of the above, we find that the payment made to the Income Tax Department out of the sale consideration would be diversion of the amount by overriding title and only the balance which came to the hands of the assessee can be brought to tax. It is relevant to note that in the case of the very same assessee in the matter of wealth-tax assessment for the assessment years 1970-71 up to 1976-77, this court held that the tax liability of the assessee''s deceased father should be deducted in determining the value of the immovable property for wealth-tax purposes.

12. As far as the second question is concerned, viz., whether the amount paid to the Income Tax Department can be treated as cost of acquisition of the capital assets, it is agreed by both sides that the principles evolved in the ''decisions of this court in Ambat Echukutty Menon Vs. Commissioner of Income Tax, Kerala, and K.V. Idiculla Vs. Commissioner of Income Tax, , would govern. This court has held that when property is inherited by an assessee the cost of acquisition of the asset is deemed to be the cost for which the previous owner acquired it, as increased by the cost of any improvement effected to the assets incurred or borne either by the previous owner or the assessee. Since the amount paid towards tax liability cannot be treated as expenditure incurred for making any additions or alterations to the capital asset, it cannot be taken as the cost of acquisition of the capital asset.

13. As far as question No. 3 is concerned, no serious arguments were addressed before us by the assessee. We are also of the view that the assessee is not entitled

to claim exemption u/s 54E, since the deposit was made only in May, 1978, and February, 1979, whereas the sale took place on March 17, 1977. The deposit was not admittedly made within six months.

14. Even though on the fourth question arguments were addressed and decisions were cited in support of their respective contentions, both sides submitted that if question No. 1 is to be answered in favour of the assessee, the issue raised in question No. 4 need not be decided in this case.

15. In the light of the above, question No. 1 is answered in favour of the assessee and against the Revenue. Questions Nos. 2 and 3 are answered against the assessee and in favour of the Revenue. We decline to answer question No. 4.

16. There will be no order as to costs.

17. Communicate a copy of this judgment under the seal of this court and the signature of the Registrar to the Income Tax Appellate Tribunal, Cochin Bench, for information.