(1954) 08 BOM CK 0017

Bombay High Court

Case No: Income-tax Reference No. 1 of 1954

The Commissioner of Income Tax		APPELLANT
	Vs	
James Anderson		RESPONDENT

Date of Decision: Aug. 25, 1954

Acts Referred:

- Succession Act, 1925 - Section 241

Citation: AIR 1955 Bom 224 : (1955) 57 BOMLR 68(1) : (1955) 57 BOMLR 68 : (1955) ILR (Bom) 91 : (1954) 26 ITR 699

Hon'ble Judges: M.C. Chagla, C.J; Tendolkar, J

Bench: Division Bench

Judgement

M.C. Chagla, C.J.

1.. The question is whether in the present case there is a distribution of capital assets under a will.

2. In order to be that there must be a distribution in specie. The distribution must be of the capital assets as such and not a conversion of the capital assets into money and a subsequent distribution .The principle underlying the proviso is that the capital assets should not have changed their form. If the legatee had sold the capital assets he could have been taxed and that tax cannot be evaded by the executor selling the capital assets.

3. Palkhivala. It is only a sale, exchange or transfer that attracts the provision of Section 12B. Unless there is a transfer there is no liability to tax u/s 12B. Secondly, it is only the transferor who is liable to be taxed u/s 12B. It has been laid down by the Supreme Court that on inheritance there is no sale, exchange or transfer. In a case of succession the question of capital gains can never arise. The estate belonged to the deceased and the property, on succession, goes by way of gift. Hence there can be no capital gain by the deceased or his estate. In the case of distribution in specie the question of capital gain

could never arise, and hence the Department''s construction of the proviso would make it completely redundant. If that construction were correct, no case which would be covered by the substantive part of the section could possibly be saved by this proviso. A capital gain can arise only when you part with a capital asset for a consideration higher than the one you paid for it. This could never be so in the case of succession. All that the proviso requires is that the transfer must be by way of distribution.

Tendolkar, J.

4. You are taxed not on the transfer by way of distribution but by reason of the sale which was prior to the distribution.

5. That makes no difference as in this case the sale was necessitated by the exigencies of distribution. Only so much of the capital assets were sold as were necessitated by the needs of distribution. Again, the words in the proviso are ''by reason of and not ''by way of. Thus all that the proviso requires is that there must be a causal connection between the distribution and the transfer. The scheme is that if a sale is voluntary, it will be taxed, but if the sale is compulsory, it will not be taxed. ''By reason of'' governs both ''compulsory acquisition'' and ''distribution''. See Section 24-B. Assessment has been made on the executor for the amount on which the deceased was assessable. Since this section specifically deals with executors, the executors can be assessed in their representative capacity only under this section.

6. M.H.K.

M.C. Chagla, C.J.

7. A very short question arises on this reference as to the proper interpretation of the third proviso to Section 12B(1) of the Indian Income Tax Act. The assessment years are 1947-48 and 1948-49, and the assessee is the administrator of the estate of one Henry Ganon. Henry Ganon died on May 13, 1945, having left a will dated November 18, 1942, and probate was issued of this will to the National Bank of India in England as the executors. The National Bank gave a power-of-attorney to the assessee and the assessee applied to the Court u/s 241 of the Indian Succession Act and obtained letters of administration with the will annexed. In the course of the administration of the estate the assessee sold shares and securities belonging to the deceased and it was found that for the assessment year 1947-48 there was a profit of Rs. 20,13,738 and for the assessment year 1948-49 the profit was Rs. 1,51,963. The Department contended that these sums represented the capital gains and they were liable to tax. The assessee''s contention was that he was not liable to pay tax on these capital gains because his case fell within the ambit of the third proviso to Section 12B(2).

8. Now, the most important facts are admitted and are not in dispute. The assessee sold shares belonging to the testator, and shares constitute capital assets within the meaning of the Act. The sale of these shares resulted in capital gain and unless the assessee

satisfies us that this capital gain is saved from taxation under some provision of the Act, the capital gain is clearly liable to tax. The charging section with regard to capital gains is Section 12B(J) which provides that tax shall be payable by an assessee under the head "capital gains" in respect of any profits or gains arising from the sale, exchange or transfer of a capital asset effected after March 31, 1946, and before April 1, 1948. There is a sale of capital assets within the period indicated in this section and therefore apart from any proviso to this section there is a clear liability upon the assessee to pay tax. The proviso relied upon is the third proviso and to the extent that it is material it provides:

Provided...that...any distribution of capital assets...under...a will...shall not, for the purpose of this section, be treated as a sale, exchange or transfer of the capital assets.

The contention of the assessee is that we have a case here where there is a distribution of capital assets under a will and therefore such a distribution cannot be treated as a sale, exchange or transfer of capital assets.

9. Now, in the first place, before we proceed to construe the third proviso, it is difficult to understand how this is a case of distribution of capital assets under a will. The capital assets dealt with by the testator by his will were the shares and admittedly there has been no distribution by the administrator of these capital assets. What the administrator has done is, he has sold the capital assets and then distributed the sale proceeds realised. Therefore, we are not dealing with the distribution of capital assets contemplated by the third proviso ; we are dealing with something quite different; we are dealing with something into which the capital asset has been converted. Therefore, in terms, the proviso has no application. This is a case of a sale of a capita] asset antecedent to the distribution of the sale proceeds and the sale falls clearly within Sub-section (1) of Section 12B and does not come within the purview of the third proviso. Mr. Palkhivala"s contention is that the third proviso deals with cases of what he chooses to call involuntary transfers and he wants us to carry forward the first part of the proviso so as to qualify the ease of distribution under a will. The first part of the proviso is:

Provided further that any transfer of capital assets by reason of the compulsory acquisition thereof under any law for the time being in force relating to the compulsory acquisition of property for public purposes....

and Mr. Palkhivala urges that we must qualify distribution of assets under a will by the expression "by reason of". In other words, according to him the Legislature intended that when a distribution takes place by reason of a direction in the will and where the testator or the administrator is compelled in the course of administration to sell the capital assets and distribute the sale proceeds, then the third proviso applies. In our opinion, it is clear that the third proviso only applies to a case where there is distribution of capital assets in specie. In our opinion, the construction suggested by Mr. Palkhivala is opposed to the plain natural meaning which we must put upon the third proviso. The suggested construction is both unnatural and strained and there is no reason whatever why that

construction should be put upon the third proviso. The third proviso deals with a simple case where an administrator or an executor transfers capital assets belonging to the testator in specie to the persons entitled to those assets. The Legislature provides that in such a case there would not be any sale, exchange or transfer as contemplated by Section 12B(1), and there is very good reason why this provision is made because when assets are transferred in specie to a legatee, Sub-section (3) of Section 12B provides that where he sells these assets he will have to pay tax on capital gain on the basis laid down in that sub-section. Therefore, the intention of the Legislature is to tax the profit made by the sale of capital assets. The incidence of taxation must fall at the time of the sale. The sale may take place by the administrator or the executor or he may choose to transfer these capital assets in specie to the legatee, in which case it is when the legatee sells the capital assets that it would attract tax. But the curious argument advanced by Mr. Palkhivala is that although a legatee would be liable to pay tax on capital gains under Sub-section (3) of Section 12B if he got the capital assets in specie, there would be no liability to pay tax at all b y anybody at any time if the executor or the administrator chose to sell the capital assets and realised them into cash, In our opinion, there is neither reason nor principle underlying this argument or contention.

10. Mr. Palkhivala says that the Legislature in the third proviso was contemplating cases of involuntary transfers and according to him the distinction is that when an administrator is compelled to sell capital assets in order to administer the estate, no question of capital gain can arise, It is only when he voluntarily sells capital assets and distributes the sale proceeds that the third proviso would have no application. In our opinion, the Legislature was not concerned with the voluntary or involuntary nature of the transaction. The sole concern of the Legislature was that if a capital asset was sold and a capital gain arose, such capital gain should be subjected to taxation. It was not the intention of the Legislature that in certain cases capital assets should escape taxation although they were sold and profit was made, and therefore the Legislature by enacting Section 12B(1) and also enacting Sub-section (3) provided for all cases of a capital asset left by a testator being sold and realised and profit being made. If the capital asset was sold before distribution, then clearly the tax would be attracted at the date of the sale, but if the administrator or the executor chose not to sell the capital asset but to transfer it or distribute it in specie, then the Legislature subjected that capital asset to tax only when the legatee or the parson interested in the estate sold that capital asset. But if Mr. Palkhivala''s contention were to be accepted, it would be open to the administrator or the executor by realising capital assets before distribution to permit these capital assets to escape the capital gains tax.

11. Mr. Palkhivala''s further contention is that the Legislature could never have contemplated when it enacted the third proviso that the cases covered by that third proviso were cases where there was distribution of capital assets in specie. Mr. Palkhivala says it is impossible ''m contend that when an executor or administrator distributes an estate in specie there could be a case of sale, exchange or transfer. Now,

there is no limit to legal ingenuity and when legal ingenuity is applied to the provisions of the Indian Income Tax Act sometimes it reaches proportions which leaves one really surprised, and it is not difficult to understand that the Legislature should have protected the assessee from a possible argument by the Department that when an executor or an administrator transfers the estate or part of the estate to the person entitled to that estate there was a transfer within the meaning of Section 12B (1). It seems to us that such an argument is not so absurd or so impossible that the Legislature could not possibly have intended to counter it by enacting the third proviso. But really in this case we are not concerned to interpret the third proviso. What we are concerned with is to decide whether there is a sale of a capital asset which has resulted in a capital gain, and as we said before it is not disputed by Mr. Palkhivala that the administrator has sold capital assets in the nature of shares and securities and has realised capital gains. There is nothing in the third proviso which saves the sale from being subjected to tax. It is not a case of distribution ; distribution came subsequent to the sale ; and therefore whatever be the nature of the distribution contemplated by the third proviso, as we are dealing with a case of a simple sale by an administrator of capital assets belonging to the estate, the interesting question as to whether the distribution contemplated by the third proviso is in specie or otherwise strictly does not arise.

12. It is then urged that the administrator is not liable to pay tax by reason of Section 24B. It is said that an administrator or an executor is only liable to pay tax which the testator would have been liable to pay, and as these capital assets were not sold by the testator it is suggested that there is no liability upon the executor or the administrator. Now, that contention is obviously untenable. Section 24B casts a liability upon the executor or the administrator to pay tax which the testator would have been liable to pay if he had not done so. But Section 24B does not limit the liability of the administrator or the executor only to the cases referred to in Section 24B. An administrator or an executor is as much an assessee under the Act as any other individual, and if he carries on business or makes profit or receives dividends or makes capital gains, he is as much liable to pay tax as any other individual. Therefore, there is no force whatever in the contention that the administrator is not liable to pay tax on capital gains because the capital assets were not realised by the testator but by the administrator himself.

13. The third question raised is as to whether the capital gains tax is ultra vires of the Legislature. We have already decided this question against the assessee and it is unnecessary to repeat the arguments which we have set out in that decision. We will merely confirm the view that we took there.

14. Therefore, we will answer the questions as follows:

(1) The sale of shares and securities by the assessee is a sale for the purpose of Section 24B(1).

(2)(a) In the negative.

(b) In the affirmative.

15. The assessee to pay the costs.