

(1992) 02 GUJ CK 0002
In the Gujarat High Court

Case No : IT Reference No. 37 of 1978 & Income-tax Reference No. 37 of 1978

Commissioner of Income Tax

APPELLANT

Vs

Daksha Ramanlal

RESPONDENT

Date of Decision : 26-02-1992

Acts Referred:

Income Tax Act, 1961 — Section 256(1), 45, 48, 48(1)(ii), 49

Citation : (1992) 65 TAXMAN 83

Hon'ble Judges : J.M. Panchal, J;G.T. Nanavati, J

Bench : Division Bench

Advocate : Mihir J. Thakore, for the Appellant; J.P. Shah, for the Respondent

Judgement

G.T. Nanavati, J.—In this reference u/s 256(1) of the income tax Act. 1961 ("the Act") , the Tribunal has referred the following question to this Court:

Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the assessee is entitled to claim deduction of Rs. 25,000 paid by her for redemption of the mortgage for the purpose of computing the capital gains?

The facts giving rise to that question, briefly stated, are as under:

2. One Surottam Hathising was the owner of land, admeasuring 584 sq. yards. He gifted half of that land to the assessee and the other half to Automi Harsha Hathising. Thus, the assessee received 292 sq. yards and became the owner of it. She sold the same during the accounting year ending on 19-10-1971, for Rs. 59,956. In the return filed for that year, she disclosed capital gain of Rs. 29,125 on the sale of the said land. Apart from other deductions, with which we are not concerned, the assessee claimed deduction of Rs. 25,000 paid by her to the mortgagee, as the land, which was gifted to her, was subject to a mortgage. The ITO rejected the assessee's claim for deduction of that amount, as he was of the view that it was not a liability which increased cost of the land. The appeal filed by the assessee to the AAC was dismissed, as the AAC agreed with the view of

the ITO that the assessee's claim for deduction of Rs. 25,000 paid to the mortgagee was not valid. The assessee then approached the Tribunal by preferring an appeal. The Tribunal held that the assessee did not sell the capital asset that she had received by way of gift; what she had sold was something more than that, viz., the interest, which the donor had transferred to the mortgagee. As she was required to redeem the mortgage and for that purpose, she had to pay Rs. 25,000 to the mortgagee, being the mortgage amount, the said cost of acquisition was also required to be taken into account while computing the capital gain. Taking that view, the Tribunal further held that the assessee was entitled to deduction of the said sum of Rs. 25,000 under clause (ii) of section 48 of the Act. The Tribunal partly allowed the appeal and directed the ITO to deduct Rs. 25,000 paid by the assessee to the mortgagee as the cost of acquisition. Aggrieved by the decision of the Tribunal, the revenue has got the reference made by the Tribunal of the question set out earlier.

3. What is submitted by the learned counsel for the revenue is that, according to the scheme of the Act, total income is required to be computed in the manner laid down in the Act. As capital gain is deemed to be income, it is required to be computed in the manner laid down in sections 48, 49 and 55 of the Act. It was submitted that as the capital asset in this case became the property of the assessee under a gift, section 49, and not section 48, would be attracted and, therefore, the cost of acquisition was required to be computed in accordance with section 55(2)(ii). Thus, what was required to be considered was the cost of acquisition of the capital asset to the previous owner and the fair market value as on 1-1-1954. The Tribunal, overlooking these provisions, and computing the capital gain in terms of section 48, committed an error and wrongly held that the sum of Rs. 25,000 paid by the assessee to the mortgagee was deductible as cost of acquisition of the asset.

4. In order to appreciate the contention raised on behalf of the revenue, it is necessary to refer to the relevant provisions of the Act. Section 45 of the Act makes any profits or gains arising from the transfer of a capital asset effected in the previous year chargeable to income tax. Capital gains is deemed to be the income of the previous year in which the transfer took place. Section 48 provides for the mode of computation and deduction. It provides that the income chargeable under the head "Capital gains" shall be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the expenditure incurred wholly and exclusively in connection with such transfer, the cost of acquisition of the capital asset and the cost of any improvement there to. Section 49(1) provides that where the capital asset becomes the property of the assessee by any of the modes of acquisition (specified in the said section) , the cost of acquisition of the assets shall be deemed to be the cost at which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be. Section 55 defines the expressions "cost of improvement" and "cost of acquisition" for the purposes of

sections 48 and 49. Sub-section (2) of that section, so far as it is material for the purpose of this case, reads as under:

Meaning of "adjusted", "cost of improvement" and "cost of acquisition". - (1)

(2) For the purposes of sections 48 and 49 "cost of acquisition", in relation to a capital asset,-

(i) where the capital asset became the property of the assessee before the 1st day of January, 1954, means the cost of acquisition of the asset to the assessee or the fair market value of the asset on the 1st day of January, 1954 at the option of the assessee;

(iii) where the capital asset became the property of the assessee by any of the modes specified in sub-section (1) of section 49, and the capital asset became the property of the previous owner before the 1st day of January, 1954, means the cost of the capital asset to the previous owner or the fair market value of the asset on the 1st day of January, 1954, at the option of the assessee;

5. On a combined reading of the above provisions, it can be said that, if the capital asset, sale of which has resulted in capital gains, became the property of the assessee under a gift, and if the capital asset became the property of the previous owner before 1-1-1954, then the cost of acquisition of such capital asset would be the cost of capital asset of the previous owner or the fair market value of the asset on 1-1-1954, depending upon the option that may be exercised by the assessee in this behalf. What is submitted by the learned counsel for the revenue is that, in this case, the land became the property of the assessee under a gift and that the said capital asset had become the property of the previous owner before 1-1-1954. The assessee had not exercised the option available to her and no material was brought on record to show as to what was the cost of the capital asset of the previous owner. The ITO, therefore, noted the fair market value of the asset on 1-1-1954 and computed the capital gain accordingly. It is submitted that the Tribunal overlooked this provision and committed an error in computing the capital gains in the mode provided by section 48(1)(ii). In support of his submission, the learned counsel relied upon a decision of the Kerala High Court in *Ambat Echukutty Menon Vs. Commissioner of Income Tax, Kerala*, . In that case, what had happened was that the assessee and his co-heirs had inherited a property, which was earlier mortgaged by the previous owner. The assessee, along with his other co-heirs, discharged the mortgage. The said property was then sold and as the assessee had one-fifth share in the property, he declared the capital gain after deducting the amount paid for clearing the encumbrance. The said deduction was claimed as the cost of acquisition. The ITO accepted the said method of computation and completed the assessment. Before the AAC, it was contended that the amount expended on discharging the mortgage ought to have been treated as the cost incurred by the assessee in effecting an improvement in the capital asset and deduction ought to

have been allowed in respect of the said amount, but that contention was rejected. The matter was then carried to the Tribunal, which also agreed with the view taken by the AAC. On a reference made to the High Court, the High Court held that the case was governed by section 49 and the cost of acquisition of the asset was deemed to be the cost at which the previous owner of the property had acquired it. As regards the claim for deduction under the head "Cost of improvement", the High Court held that in order to entitle the assessee to claim a deduction in respect of the cost of any improvement, the expenditure should have been incurred in making any additions or alterations to the capital asset that was originally purchased by the previous owner. If subsequent to the purchase of the property by the previous owner, it was mortgaged by him and that mortgage was later discharged either by himself or by his successor-in-interest, that would not constitute an improvement to the capital asset, which originally became the property of the previous owner. Thus, that was a case where the only question which arose for consideration was whether the amount spent by the assessee in order to discharge the mortgage created by the previous owner could be regarded as the cost of effecting any improvement to the capital asset. Even though we do not find any discussion in that judgment as regards question No. 1, while answering the question, the High Court did hold that the Tribunal was right in holding that the sum spent by the assessee did not represent the cost of acquisition of the capital asset within the meaning of section 48, read with section 55(2). Thus, though the said decision of the Kerala High Court supports the learned counsel, with respect, it has to be stated that it does not contain the reasons for taking that view and, therefore, the said decision is not of much help to us.

6. Reliance was also placed on the decision of the Madras High court in Commissioner of Income Tax Vs. V. Indira, . In that case, the assessee was required to pay a certain sum by way of compromise in a suit, wherein title to the property, which was gifted to her by her father, was challenged. While computing the capital gains arising from the sale of the property by the assessee, the sum paid by way of compromise was treated as cost of improvement to the property, and on that basis, a claim for deduction was made. That claim was rejected by the ITO as well as by the AAC. The Tribunal, however, held that by paying that amount, the assessee had perfected her title to the property by removing the cloud cast on it by a rival claimant and this amounted to both addition and improvement to the title to the capital asset and, thus, constituted cost of acquisition, within the meaning of section 49(1). The Madras High Court, in a reference made at the instance of the Commissioner, held that, as the asset had become the property of the assessee by way of gift, the cost of acquisition was required to be computed in accordance with section 49(1) and, therefore, the sum paid by the assessee could not have been treated as cost to the previous owner and, therefore, it did not qualify for deduction as cost of acquisition of the property. It was held that the said amount could not have been allowed as a deduction as "cost of any improvement thereto", as the expression

"thereto" would cover a case, where the amount is expended on the asset itself. As the amount had been paid only to improve the title of the owner rather than improving the asset as such, there was no scope for deducting the amount in the computation of the capital gains. This decision does support the contention raised by the learned counsel for the revenue.

7. Reliance was also placed upon the decision of the Full Bench of the Madras High Court in *S. Valliammai and Another Vs. Commissioner of Income Tax, Madras*, .

The question, which had arisen in that case for consideration, was whether the amount paid as estate duty in respect of the property sold by the assessee could be deducted while computing the capital gains arising on the sale of such properties. In our opinion, the said decision is not relevant for our purpose, as payment by an assessee for discharging the mortgage is quite different in nature from payment made by way of estate duty.

8. Though the Madras and Kerala High Courts have taken the view that, when a capital asset is received by an assessee by one of the modes specified by section 49, what has to be taken into consideration is the cost of acquisition to the previous owner and any sums paid by the assessee for removing any encumbrance thereon cannot be deducted while computing the capital gains on sale of such property. With due respect to them, we cannot agree with that view. In our opinion, what has been overlooked in those cases is that the word "property" does not mean merely the physical property, but also means right, title or interest in it. In case of a mortgage or lease, different persons will have different rights in the same property. If a person is an absolute owner of the property, then it can be said that he has all the rights and interest in that property. If the property is mortgaged or leased, then the owner of the property would possess only those rights, which are not transferred to the mortgagee or the lessee, as the case may be. When a person, who has mortgaged the property, transfers it to another person, what he transfers is only those rights, which he possesses. The transferee would get the property subject to the rights created by the previous owner in favour of others. This aspect does not appear to have been considered while deciding those cases. If we are right in taking this view, then it follows that when the previous owner gifted the mortgaged property to the assessee, what he had transferred to the assessee was the right, title or interest, which he had in that property. When the assessee discharged the mortgage by paying Rs. 25,000 to the mortgagee, what he did was to purchase that right or interest, which the mortgagor did not then possess and which the mortgagee had in the property. When the assessee sold the property, he did not merely sell the right, title or interest, which he had received from the donor, but also the right, title or interest, which he had purchased from the mortgagee. For this reason, the case would not be covered by section 49(1)(ii) nor by section 55(2)(ii) for the purpose of computation of the capital gains.

Section 55(2) can have application only in those cases where the capital asset

becomes the property of the assessee by any of the modes specified by sub-section (1) of section 49. The capital asset, which the assessee sold, had not become the property of the assessee by one of the modes specified by sub-section (1) of section 49. It was partly by that mode and partly by purchasing the interest of the mortgagee in the property. Therefore, the case, in our opinion, will be governed, either by section 48, read with section 55(2)(i) or partly by section 48(1)(ii) and partly by section 49(1), read with section 55(2)(i).

In either case, what is required to be considered is the cost of acquisition of the asset to the assessee. Payment of Rs. 25,000 to the mortgagee for removing that encumbrance was certainly the cost of acquisition of the interest of the mortgagee and, therefore, that was required to be taken into account for the purpose of computing the total cost of acquisition of the property, which the assessee sold and thereby made capital gains.

9. As we are taking this view, it is not necessary to consider the two decisions in *Miss Dhun Dadabhoy Kapadia Vs. Commissioner of Income Tax, Bombay*, and *Commissioner of Income Tax, Andhra Pradesh, Hyderabad Vs. Bilquis Jahan Begum*, , relied upon by the learned counsel for the respondent in support of his contention that in working out the capital gains or loss, the principles that have to be applied are those which are a part of the commercial practice or which an ordinary man of business will resort to when making computation for his business purpose.

10. The view which we have taken also gets support from the decision of the Madras High Court in *Commissioner of Income Tax Vs. C.V. Soundararajan and Another*, . In that case, the assessee had paid a certain sum to his mother in order to obtain relinquishment of her right of residence in the property, which the assessee sold. While computing the capital gains arising from the sale of that property, the assessee claimed deduction for the sum paid to the mother. The ITO allowed that claim, but the Commissioner, exercising his revisional powers, set aside the order giving deductions. The Tribunal held that the money received by the mother was for extinguishment of her right of residence in the property and, hence, it could not be taken into the computation of capital gains and, accordingly, directed its deduction. As the Tribunal refused to draw up a case and refer the same to the Madras High Court, the Commissioner filed an application to the Madras High Court. While dismissing that application, the High Court held that as the assessee did not have the benefit of the sum which, in fact, had been paid to the mother as consideration for relinquishing her life interest in the property, the said sum was required to be excluded for the purpose of computation of capital gains. The High Court observed that when the interest of the mother in the property in question had been purchased by getting a relinquishment for a consideration, the sum paid as consideration could not be taken to be consideration paid in respect of the interest of the assessee. Thus, the sum which the son was required to pay to the mother was held excludible while computing the capital gains. For the reasons stated above, the question is

answered in the affirmative, i.e., in favour of the assessee and against the revenue, with no order as to costs.