

(1996) 10 KL CK 0041

In the High Court Of Kerala

Case No : Income-tax Reference No's. 40, 41, 42 and 43 of 1992 and 94 of 1994

Commissioner of Income Tax

APPELLANT

Vs

K.T. Mathew

RESPONDENT

Date of Decision : 23-10-1996

Acts Referred:

Citation : (1998) 233 ITR 770

Hon'ble Judges : V.V. Kamat, J;K. Narayana Kurup, J

Bench : Division Bench

Advocate : P.K.R. Menon, for the Appellant; P.G.K. Warriar and P.K. Suresh K Umar, for the Respondent

Judgement

V.V. Kamat, J.—All these five references really centre around our answer as to whether a valid trust is created and thereby the property and naturally the income therefrom gets transferred to the said trust. In other words, out of the following three questions expecting our answer, the fate would be determined by our answer to question No. 1. The three questions are as follows :

"1. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in law in holding that there was a valid trust ?

2. If the answer to the above question is in the negative, whether the Appellate Tribunal was justified on the facts and in the circumstances of the case in deleting the income from the Victory Offset Printers from the assessment of the assessee ?

3. If the answer to the second question is in the negative, whether on the facts and in the circumstances of the case, the Appellate Tribunal was justified in dismissing the Revenue's quantum appeal without going into the merits of the contentions ?"

2. They came before us in pursuance of the earlier order dated October 30, 1991, of this court in O. P. Nos. 5955, 6147, 6552 and 6604 of 1990. In fact,

before the assessing authority--income tax Officer, CC-II, Ernakulam, proceedings were initiated against the assessee, Sri K. T. Mathew, as an individual, for the assessment years 1980-81 and 1981-82. Similar situation relates to the same assessee for the assessment year 1982-83 with regard to the same questions, being before us with the subject-matter of I. T. R. No. 94 of 1994. The view taken by the Income Tax Officer is confirmed by the first appellate authority--the Commissioner of Income Tax (Appeals), Ernakulam, as far as the questions are concerned with little modifications. The first appellate authority's order gave rise to four second appeals before the Income Tax Appellate Tribunal, two by the assessee and two by the Revenue, each covering the assessment years 1980-81 and 1981-82. However, for the assessment year 1982-83, in view of the similar answer, the Revenue has approached this court on the basis of questions referred by the Income Tax Appellate Tribunal. In view of this position of the questions being referred to by the Tribunal with regard to this assessment year, there is only one reference in regard thereto. It is necessary to complete the record of this judgment by reproducing the two questions referred to therein which are as follows :

"1. Whether, on the facts and in the circumstances of the case, the Tribunal is right in law and fact in holding that there was a valid trust ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal is right in law and fact in holding (confirming the order of the Commissioner of Income Tax (Appeals)) that the income belonging to Fleming Trust is not the income of the assessee and in deleting the addition of Rs. 1,30,276 ?"

3. It would be seen, as stated at the outset, that the real question is the determination as to whether the trust was validly created.

4. There is no dispute about the factual matrix. The assessee-Sri K. T. Mathew--was carrying on the business of an offset press under the name and style "Victory Offset Printers" at Kunnamkulam. A trust came to be created by a deed dated May 2, 1979 (annexure-E). The trustees are the present assessee, Sri K. T. Mathew, and his wife, Mrs. K. C. Omana. A perusal of the trust deed would show that they are the parents of a minor, K. M. Flemings, who is the beneficiary under the trust. The beneficiary is possessed of funds of his own and the creation of the trust is with a desire that the funds of the beneficiary should be properly and profitably managed. It is for this purpose the trust is constituted in respect of the funds transferred to the trust and such other funds, properties and assets to be acquired by the trust thereafter. The trust was initially created with a capital formation of Rs. 5,001.

5. Clause 7 of the said deed of trust specifies the powers in the matters of administration of the trust. Clauses 8, 9 and 10 refer to the problems as succession of trustees by a process of nomination, a provision that the trustees shall hold office during their lifetime leaving option of resignation and the requirement of resort to co-option. Clause 11 of the document makes the

present assessee, Sri K. T. Mathew, as the managing trustee with powers to attend to the day-to-day affairs. Clause 12 specifies exercise of powers of the trustees by the managing trustee by himself.

6. The factual matrix further refers to a partnership firm in the name and style of "Victory Paper Stores" admitting the minor, K. M. Flemings, to the benefit of the said partnership firm. In that process, as far as the partnership firm is concerned, in its account there was a credit entry of Rs. 3,31,469, dated March 31, 1979. Obviously, this was a credit entry in the name of the minor son admitted to the benefits of the partnership firm.

7. It is in this situation there comes into existence on April 2, 1979, a document entered into by the present assessee, Sri K. T. Mathew, in his capacity as the individual proprietor of the business concern in the name and style of "Victory Offset Printers" and the trust for the sale of the printing business to the trust in its entirety for a consideration of Rs. 3,79,810.66. This amount of consideration is shown in the document as the book value of the individual proprietary business of the present assessee.

8. In the accounts submitted this amount of Rs. 3,79,810.66 is accounted by way of adjustment in the account of the minor, K. M. Flemings. It would be obvious that this credit entry related to the partnership firm in the name and style of "Victory Paper Stores" and adjustment in the account of the minor who was admitted to the benefits of the partnership was also with reference to the accounts of the partnership in the name and style of "Victory Paper Stores". It is a corresponding credit entry in favour of the assessee in the accounts of the firm and it is seen to be showing that the balance was treated as a loan.

9. On the basis of such a factual matrix, the proceedings before the Income Tax Officer resulted in the rejection of the assessee's claim that the income from the Victory Offset Printers, by virtue of the trust deed is to be assessed in the hands of the trust and not in the hands of the assessee as the property got transferred by virtue of the concerned trust deed referred to above. The Income Tax Officer took the view that the immediate purpose of the formation of the trust is seen to be nothing but the reduction of tax liability. The Income Tax Officer considered it to be a sweeping statement that the beneficiary K. M. Flemings, minor son of the assessee, Sri K. T. Mathew, is said to be possessed of funds of his own. The officer observed that Sri K. M. Flemings being a minor and having no independent source of income cannot be said to have own funds and the provision in the document of trust in regard thereto would have to be understood to be vague in regard thereto. The Income Tax Officer thought that the real purpose of creating such a trust is to keep the business of printing in the hands of the assessee and at the same time show it as being carried on for the benefit of his son and thereby get a substantial reduction in tax liability.

10. With regard to both assessment years, the proceedings reached the Commissioner of Income Tax (Appeals), Ernakulam, as the first appellate

authority. The same submission was reinforced that with the formation of the trust and the creation of the agreement of sale (annexures-E and F), the business that was being carried on in the name and style of "Victory Offset Printers", Kunnamkulam, got transferred to the trust and thereby the assessee ceased to be the owner of the business as an individual with effect from the date of such transfer--April 2, 1979. It was also submitted that a proper and legal arrangement like this, if it has been thought of and executed for reduction of tax burden, the said arrangement cannot be a reason for negating the effect of such agreement which is otherwise legally sound. In the context a pointer was brought to the notice of the authority that the assessment has already been made on the trust in respect of the income from the press and in such circumstances the same income should not have been taxed again in the hands of the appellant as an individual unless a conclusion gets established that the deed of trust and the agreement (annexures-E and F), are found sham and colourable in the state of the situation. Again we have to record that the first appellate authority has given only one paragraph of 30 lines for this question-- paragraph 7. We find only one sentence and it is in agreement with the Income Tax Officer that the whole arrangement which is an exercise in tax reduction is a sham transaction. The authority further observes that the appellant who was the owner continued to run the press. His dual capacity cannot change the ownership of the income. It is not known from where exactly the initial contribution of Rs. 5,001 was received. It is then observed that if the entire funds of the trust were those of the minor, the creation of the trust without the permission of the civil court is invalid. The authority observed that it is not proper to burden the minor with the liability of paying the balance amount to the trustee together with interest at the rate of 12 per cent, per annum. The authority also found incongruity with reference to the situation that the property of the trust legally vests in the trustees and the appellant acting as the seller and the buyer of the property claiming dual capacity is also contrary to the accepted notions of the trust. It is in this process of reasoning the submissions were rejected endorsing that the Income Tax Officer has made the assessment after detailed enquiries and giving full opportunity to the concerned persons. Reading the two orders, it will have to be seen that the approach is beset with the logical fallacy of putting the cart before the horse. It is not because the arrangement results in the reduction of the tax liability that the arrangement gets the description of being a sham transaction. Capital formation with reference to the trust of Rs. 5,001 is doubted and even the fact of a minor being possessed of funds is also considered to be a sweeping statement. The present assessee who also happens to be the managing trustee under the document of trust is also understood to be acting contrary to the accepted notions of the trust. Apart therefrom with reference to the observations of the two authorities that the whole arrangement which is an exercise in tax reduction is a sham transaction is unsupported by any material in regard thereto on record.

11. The further travel of the proceedings before the Income Tax Appellate

Tribunal, Cochin Bench--the second appellate authority--shows that it was contended that it was a valid trust and it was duly constituted in respect of the amounts belonging to the minor with the partnership firm of which the minor was admitted to the benefits. It was also submitted that the whole transaction has consideration relating to the transfer of the business with the funds owned by the minor. It was submitted on behalf of the Revenue that the transaction was invalid because it did not reveal the source of the initial sum of Rs. 5,001 with which it was created, taking it to be the base of the submission that once the trust was invalidated, the subsequent transaction also became non est. The submission was reiterated that the arrangement resulting into the transaction of sale entered into with the funds of the minor was only a device to reduce the tax liability because the assessee was virtually in control of the business, may be in the capacity of a trustee. It was in effect no change in -reality in the manner of running of the business as a proprietor. The Tribunal considered the question in the process of reasoning commencing with paragraph 6 of its judgment, the Tribunal took up the question as to whether the trust is valid. The Tribunal found that it is not-necessary that the trustee must be the owner of the subject-matter of the trust before declaring a trust. The Tribunal sought support from the statutory provisions of Section 94 of the Indian Trusts Act that the trust could be understood as valid if a trust is declared by a person with reference to the property belonging to another, but for the benefit of that person. The Tribunal recorded a fact-finding that the trust was validly and legally created as per the provisions of the trust deed (annexure-E).

12. The Tribunal also recorded that it was a genuine trust. Examining the factual situations, the Tribunal observed that the transaction dated April 2, 1979 (annexure-F) showed the purchase of the business for the benefit of the minor and the purchase was out of the funds of the minor. The Tribunal examined the situation and was unable to record that it is only a paper transaction without actually giving effect to it. The Tribunal has observed that the funds of the minor with the partnership firm have been transferred in the accounts of the trust, showing that the transaction has been given effect to. The Tribunal has recorded that as long as the transaction is a lawful transaction and was a transaction for consideration, its legal effect cannot be ignored only because the tax liability of the transferor gets reduced. The Tribunal also considered the submission that in fact it was the assessee who was in control of the business and this was by reason of the factual position that he himself happens to be the trustee as well as the guardian of the minor.

13. Learned senior tax counsel, after taking us through all the orders passed by the authorities in the first instance, brought to our notice Section 48 of the Indian Trusts Act, 1882, to submit that all the trustees must join in the execution of the trust and, therefore, any transaction by anyone of them would not be legally understandable in the absence of a situation of this joint acting. In this context, learned counsel referred to the document of the trust (annexure-E). Learned senior tax counsel brought to our notice that the trust deed refers to the

assessee, K. T. Mathew, and his wife, Mrs. K. C. Omana, as the trustees, the first trustee and the second trustee. Learned counsel also submitted that in view of the provisions of Section 48 of the Indian Trusts Act, 1882, the transaction has to be entered for and on behalf of the trust by both of them and as such the agreement of sale dated April 2, 1979, would not create a valid and legal title of transfer because the wife, Mrs. Omana Mathew, represented the trust in the matter of transfer of the property belonging to Sri K. T. Mathew as an individual who was also the managing trustee under the deed of trust.

14. We have already referred to Clauses 11 and 12 of the trust deed to the effect that K. T. Mathew would be the managing trustee and his functions specified in the deed of trust in the context. The text of Section 48 itself creates an exception to the joint acting of the trustees with reference to the instrument of the trust providing otherwise. The agreement (annexure-F) is a sale by K. T. Mathew who was undisputedly the proprietor of the proprietary concern in the name and style of "Victory Offset Printers" at Kunnankulam. Therefore, K. T. Mathew could be considered as an individual selling his property under the agreement dated April 2, 1979 (annexure-F). The document is between him as an individual and the trust creating a vendor and vendee relationship. Reading the document further shows that this Fleming Trust is represented by Mrs. Omana Mathew. This was the inevitable factual situation in view of the peculiarities that one of the trustees was the vendor selling the property to the trust and under the peculiarities of the circumstances the trust was represented by the other trustee, Mrs. Omana Mathew, who happens to be none other than the wife of K. T. Mathew. It is also undisputed that there is no other trustee. The deed of trust creates a specific position satisfying the requirements of Section 48 of the Indian Trusts Act, 1882. It is elementary that Section 5 of the Transfer of Property Act, 1882, understands a transfer of property to be an act by which a living person conveys property, in present or in future, to one or more other living persons, or to himself, and one or more other living persons and the provision also understands such "living person" to include a company or association or body of individuals. The property and its transfer gets inevitably related to the act of transfer. Reading the agreement (annexure-F) it is clear that all the assets of the business including plant and machinery, stock-in-trade, raw materials, work-in-progress, office equipment, furniture and fittings, tenancies, permits, trade name, goodwill and all other trade rights stand transferred under the agreement to the trust. The document also spells out consideration of Rs. 3,79,810.66. Clause 7 of the agreement also provides the nature of adjustment and it is on the basis of the agreement that the property stood transferred. It is not possible to accept the submission of learned counsel that the document does not create a transfer in any way.

15. This court had an occasion to consider, with advantage, the jurisprudential aspect relied upon by the Delhi High Court in Commissioner of Income Tax Vs. Mirdu Hari Dalmia, with reference to the situation that the law always recognises many different capacities in which a man may act, in I. T. R. No. 9 of 1992

(Commissioner of Gift-tax Vs. K.R. Kumaran, decided on March 26, 1996). It would be of benefit to reproduce the same paragraph which is a passage from Salmond's Jurisprudence, 12th edn. page 304, paragraph 65. We borrow the said quotation in the context and it is as follows (page 687) :

"English law recognises many different capacities in which a man may act. Often he has power to do an act in an official or representative capacity when he would have no power to do the act in his private capacity or on his own account. All sorts of difficult questions arise out of these distinctions : for instance, whether a person on a particular occasion was acting as trustee for fund A or as trustee for B ; whether a director has the powers and duties of a trustee ; whether an executor has turned into a trustee and so on. These troubles need not concern us here; the only point to be noticed is that the mere fact that a man has two or more capacities does not give him the power to enter into a legal transaction with himself. Double capacity does not connote double personality. For instance, at common law, a man could not sue himself or contract with himself, or convey property to himself ; and it made no difference that he was acting on each side in a different capacity. So rigorous was the Rule that, if the same party appeared on both sides of a contract, even though accompanied by different parties in each case, the whole contract was void. In many cases the Rule worked hardship, and its consequences had to be mitigated."

16. It is clear that acting in double capacity is not prohibited. What is prohibited is that a man cannot sue himself or contract with himself or convey property to himself. We must state that this court had an occasion to consider the above observations in I. T. R. No. 9 of 1992 (Commissioner of Gift-tax Vs. K.R. Kumaran,) where one of us-myself-dictated the judgment for the Bench. Factually, the question was whether the father could have acted in dual capacity as the party proposing advancement of loan and at the other end the party acting as the guardian accepting the amount for and on behalf of the minor son. In the context of the reasoning, this court had an occasion to consider the enforceability of such acts of law with reference to the provisions of the law of contract, especially the competency of the parties to contract. In fact, learned senior tax counsel strenuously urged before us to follow the principle. It must be stated that there cannot be any quarrel with the principle, but the principle is not applicable in the fullest extent as sought to be contended by learned senior tax counsel. The agreement (annexure-F) is a document of sale by K. T. Mathew in his capacity as the proprietor of the subject-matter of the document. The transfer is in favour of the trust, and the trust, in the peculiarities of the situation, is represented by the remaining trustee, may be happening to be the wife of K. T. Mathew. The dual capacity of the same person or individual is not really a matter under consideration. The agreement is clearly between the vendor and the vendee where the vendor is an individual and the vendee is a trust and in the transaction the trust is represented by the remaining trustee. In fact in the above quotation even the position of a trustee is taken up and it is observed that these factual troubles need not concern the situation because the

only point to be noticed is that the mere fact that the man has two or more capacities would not give him power to enter into a legal transaction with himself. Double capacity does not denote double personality and it is in this context it is observed that a man could not sue himself or contract with himself or convey property to himself. This is not the position here. As already stated, the document creates transfer of the property held by K. T. Mathew in favour of the trust and the document, as we have already observed, shows consideration. In this context, we are strengthened by the decision of the apex court in *Tulsidas Kilachand Vs. The Commissioner of Income Tax, Bombay City I*, in the context of understanding as to what effects a transfer in accordance with the provisions of the Indian Trusts Act. It is observed by the apex court at page 6 that in fact there is no legal need that the vendor must transfer the property to himself by the trustee because the law implies that such a transfer has been made by him, and no overt act except a declaration of trust is necessary. It is also observed that even under the Transfer of Property Act, which we have considered independently hereinbefore, there can be a transfer by a person to himself or to himself and another person or persons.

17. In view of the above position it is not possible to accept the submission of learned tax counsel that the documents fail to make out transfer of property. In view of the foregoing discussion, we do not find that the Income Tax Appellate Tribunal, Cochin Bench, has gone astray in any way either on facts or in regard to the position of law. Left to ourselves, we would also have reached the same conclusion. Therefore, once we hold that there was a valid trust, in view of our above discussion it is needless, to state that transfer is the consequence flowing therefrom.

18. For all the above reasons in ITR Nos. 40 to 43 of 1992, we answer question No. 1 in the affirmative-in favour of the assessee and against the Revenue. We answer question No. 2 also in the affirmative-in favour of the lessee and against the Revenue. In view of our answers to questions No. 1 and 2, answering question No. 3 does not arise and we decline to do so.

19. In I T. R. No. 94 of 1994, both the questions are answered in the affirmative-in favour of the assessee and against the Revenue.

20. A copy of this judgment under the seal of the court and the signature of the Registrar shall be forwarded to the Income Tax Appellate Tribunal, Cochin Bench, as required by law.