**(1982) 09 MAD CK 0045**

**In the Madras High Court**

**Case No :** Tax Case No. 171 of 1976

Commissioner of Income Tax — APPELLANT

Vs

N.S. Krishna Rao — RESPONDENT

**Date of Decision :** 24-09-1982

**Acts Referred:**

Income Tax Act, 1961 — Section 49, 50, 55(2)

**Citation :** (1983) 14 TAXMAN 62

**Hon'ble Judges :** V. Ramaswami, J;Balasubrahmanyan, J

**Bench :** Division Bench

## Judgement

Balasubrahmanyan, J.—The primary question in this income tax reference is about the proper way to ascertain the cost of a capital asset for the purpose of computation of the capital gains arising there from. One Krishna Rao owned a steel press. This is an item of machinery useful for bus body building operations. Krishna Rao was earning income from the lease of the machinery. The machinery belonged to Krishna Rao as his separate property although there was all the time a joint family of which he was the karta. On 1-11-1969, Krishna Rao declared, by writing, that the machinery shall be the property of joint family. Barely two months afterwards, on 31-12-1969, this item of machinery was disposed of as an item of joint family property. It was sold to a third party. The sale consideration received by the family was Rs. 44,000. It was conceded that the family was liable to capital gains tax on this transaction. But the question arose as to how the cost of this machine in the hands of the assessee-family had to be determined for the purpose of quantifying the capital gains. When the machinery was Krishna Rao''s separate property, its written down value (WDV) in his hands was Rs. 25,639, just before it became the property of the assessee-family on 1-11-1969. The ITO adopted this value as the cost to the assessee-family of the machinery, and proceeded on that basis to determine the capital gains.

2. The Tribunal took a different view in appeal. They rejected the WDV as the basis of cost, and adopted the market value as on 1-11-1969 as representing the

cost to the assessee-family, for the purpose of assessment. The market value of the machinery as on 1-11-1969 was ascertained to be Rs. 44,000. The Tribunal directed this figure to be substituted for Rs. 25,639 adopted as cost of the capital asset in the assessment order.

3. In this reference, the department canvasses the correctness of the Tribunal''s decision. Under the scheme of the income tax Act, 1961, the charge to tax on capital gains is not the assessee''s gross realization on the transfer of the capital asset by sale, exchange and the like. The tax attached only to what may be described as the net capital gains. This necessarily involves that in every case, the cost of the capital asset must be deducted from the gross receipts realized on the transfer of the capital asset. Normally, the cost of the capital asset to be deducted is the cost to the assessee who realizes the capital gains. This stands to reason. But the Act makes for a few exceptions. In these exceptional cases, the cost to be adopted is the cost to the previous owner of the capital asset, and not cost to the assessee himself who got the asset from the previous owner. Section 49 of the income tax Act, 1961 (''the Act'') lists out these exceptional cases. For instance, whether the assessee got the capital asset under a gift inter vivos or under a will, the cost to the donor or the testator, as the case may be, has to be adopted as the assessee''s cost. Again where a Hindu coparcener gets the capital asset in a family partition, his cost must be based only on the cost at which the joint family had acquired the asset for itself. What we have in this reference is the reverse case of a joint family becoming the owner, by operation of the relevant rule of Hindu law, of a separate property of an individual member of that family by the process of blending or conversion. This reverse case has now been specifically provided for under clause (iv) of section 49, but this clause was introduced in section 49 only in 1975 and it came into force only on 1-4-1976. The case under reference is concerned with an assessment to capital gains for the assessment year 1971-72. Clause (iv) had not come into the statute book at the time section 49 or any other provision in the Act did not provide that the cost at which an individual coparcener acquired a capital asset as his separate property must be regarded as the cost of acquisition of his joint family where the coparcener throws that capital asset into the joint family hotchpot. We must, therefore, examine the question in this case on general principles and not on the basis of any express statutory provision.

4. In the course of argument, Mr. Jayaraman, for the revenue made a reference to section 50 of the Act. This provision enacts that in ascertaining the cost of a depreciable asset like machinery, the depreciation actually allowed to it in the assessment shall be deducted. This provision, however, will not apply to the present case, because no depreciation was actually allowed in the assessment of the assessee-family. It is true that depreciation had been allowed to this machinery in the assessment of Krishna Rao, and that is how its WDV has become ascertainable. But the WDV in the hands of Krishna Rao is irrelevant. The question does not arise in his assessment, but in the context of the assessment of the joint family where the machinery has not suffered any

 

depreciation and has not been granted any depreciation. As we earlier mentioned, the machinery stayed with the family for a few days alone, before the family sold into it to a third party.

5. Mr. Jayaraman, however, urged that even if section 50 does not apply because section 49 does not apply for the assessment year in question, still the WDV of the machinery affords a reasonable basis for ascertaining the cost in the hands of the assessee-family, because that was the value in the hands of Krishna Rao when he gave it over, gratis, to the family. Learned counsel cited a Supreme Court decision D.S. Bist and Sons, Nainital Vs. Commissioner of Income Tax, Delhi Central, New Delhi, as affording guidance in the matter. In the case before the Supreme Court the depreciation on certain trucks already granted to an assessee-family had reduced their WDV to nil. It was in that situation that the family business, with all its trucks and other assets, was taken over by a partnership concern which was formed by the members of the family who had got divided in the mean time. The question before the Supreme Court was whether in the hands of the successor firm the trucks which had become its assets must be revalued for purposes of working out depreciation allowances, or whether they should be pinned to their earlier WDV which was nil.

6. The Supreme Court rejected the contention with the following observations:

...Where a business is taken over as a running concern by an assessee, the cost to it of the assets must ordinarily turn on the value of the assets as on the date of acquisition... It cannot be disputed that the actual cost to the appellant of the three trucks must be regarded as nil, and that being so no depreciation can be said to have been ever actually allowed to the appellant." (p. 133)

7. Mr. Jayaraman urged that the same principle must be applied to the present case. He said that since the WDV of the machinery in the hands of Krishna Rao was Rs. 25,639 that must be taken as and when the asset was turned over the cost of the machinery to the assessee-family, when it became the property of the family by being thrown into the family hotchpot.

8. Mr. Rangarajan, learned counsel for the assessee, said that Bist & Sons (supra) did not raise any question of ascertaining of cost in the context of capital gains taxation. He said that the Supreme Court themselves were careful to point out that they were not going into any aspect of levy having regard to the limited scope of the question at issued before them.

9. We are, however, of the view that the Supreme Court''s decision even though it appertains to the ascertainment of cost for purposes of working out depreciation allowance or balancing charge, lays down a principle which can be reasonably applied to the present case. The principle can be stated thus: Where a depreciable asset in the hands of one is given over gratis to another, the gratuitous transferee must be treated as having acquired that asset at its then WDV. Applying this principle, we are satisfied that the ITO was correct in determining the assessee family''s cost of acquisition of the machinery at Rs.

25,639 which is the figure of WDV which the machinery bore at the time the family got it, gratis, from Krishna Rao.

10. The Tribunal had expressed the view that cost of acquisition must be equated to real value to the acquirer where the acquisition is obtained, as in this case, without consideration. By real value the Tribunal meant intrinsic value or market value. We do not think there is any scope for introducing into the discussion of cost of acquisition, such notions as real value or intrinsic value and on that basis proceed to equate market value as representing real value or intrinsic value. In cases of the present kind we deal not with any valuation question, but with the ascertainment of cost arising out of transactions in which two parties figure. The cost to the assessee family must, therefore, be ascertained not in the abstract, but, with a sense of reality on the basis of what it was in the hands of Krishna Rao. To ascertain cost historically is a recognised method of ascertaining it. The WDV in the hands of Krishna Rao, therefore, affords the only proper basis for cost in the hands of the assessee-family.

11. Learned counsel for the department said that the income tax Act, in certain special situations, taken market value as the guiding figure for ascertainment of cost. He cited section 55(2) of the Act. His point was that in cases not covered by section 55(2) market value cannot be taken to be the cost of acquisition of the capital asset. We, however, think that it is unnecessary in this case to decide the larger question whether section 55(2) is exhaustive. It remains for us to state the question of law referred to us, for entering our formal answers thereto. The questions are as under:

1. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the market value of the assets on the date on which the property was thrown into the common hotchpot of the HUF by the individual coparcener is to be taken as the cost of acquisition?

2. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in deleting the capital gains brought to tax in the assessment year 1971-72?

12. Our answer to the first question is against the assessee. We hold that cost of acquisition of the asset in this case must be taken to be the WDV of the asset to Krishna Rao from whom the assessee acquired it. The answer to the second question is consequential. The answer is that the assessment of capital gains made by the ITO on the basis that the cost of acquisition was Rs. 25,639 was correct. The decision, to the contrary, rendered by the Tribunal is wrong. In the circumstances, the reference is answered accordingly. The department will have its costs. Counsel fee Rs. 500.