

(1993) 07 KL CK 0061

In the High Court Of Kerala

Case No : Income-tax Reference No. 143 and 144 of 1983

Commissioner of Wealth-tax

APPELLANT

Vs

E.K. Mathew

RESPONDENT

Date of Decision : 13-07-1993

Acts Referred:

Wealth Tax Act, 1957 — Section 2, 3, 4, 5, 5(1)
Wealth Tax Rules, 1957 — Rule 2

Citation : (1993) 113 CTR 336 : (1993) 3 ILR (Ker) 822 : (1994) 207 ITR 71

Hon'ble Judges : T.L. Viswanatha Iyer, J;P. Krishnamoorthy, J

Bench : Division Bench

Advocate : N.R.K. Nair, for the Appellant; G. Sivarajan, for the Respondent

Judgement

P. Krishnamoorthy, J.—At the instance of the Revenue, the Income Tax Appellate Tribunal has referred the following three questions of law u/s 27 of the Wealth-tax Act, 1957 :

"(1) 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 exemption of Rs. 1,50,000 u/s 5(1)(iva) of the Wealth-tax Act ?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that in working out the interest of the partners in Messrs. E.K. Mathew and Bros., the entire liability to the Federal Bank has to be allowed against the net wealth of the firm in the computation under rule 2 of the Wealth-tax Rules ?

(3) Whether, on the facts and in the circumstances of the case, the Tribunal is right in law in holding that in evaluating the interest of the partners in Messrs. E. K. Mathew and Bros., and with particular reference to tea estate, the loan taken by the firm from Federal Bank is not to be excluded by applying the provisions of Section 2(m)(ii) of the Wealth-tax Act ?"

2. We shall state the facts of the case so far as it is necessary to answer the

questions referred. The two references arise out of assessment proceedings in respect of two assessees who are partners of a firm, Messrs. E. K. Mathew and Bros., for the assessment years 1976-77 and 1977-78. Common issues arise in both the cases. The partnership owned among other assets a tea estate called "Alampally Estate" and a rubber estate called "Glenrock Rubber Estate". The computation of the interest of partners in these two estates was in dispute. The assessees had claimed exemption u/s 5(1)(iva) in respect of the interest they had in the estates. The partnership had taken a loan on the security of the property in Alampally Estate from the Federal Bank.

3. The Wealth-tax Officer denied exemption u/s 5(1)(iva) on the ground that the interest of a partner in a firm is a movable asset and cannot be treated as agricultural land. Regarding the loan from the Federal Bank, the Wealth-tax Officer held that the debt being secured on a property in respect of which wealth-tax is not chargeable, the same cannot be taken into account in determining the net wealth of the assessee u/s 2(m)(ii) of the Act. In appeal, the Appellate Assistant Commissioner confirmed the view taken by the Wealth-tax Officer on these questions. On appeal by the assessees to the Tribunal, the Tribunal directed the Wealth-tax Officer to allow exemption u/s 5(1)(iva) for the two assessment years. The Tribunal further held that the loan from Federal Bank even though charged on agricultural land would not fall u/s 2(m)(ii) for the purpose of determining the net wealth of the firm. Accordingly, the Tribunal directed the Wealth-tax Officer to work out the interest of the partners by deducting the entire liability of the firm to the Federal Bank from the assets of the firm in the computation under rule 2 of the Wealth-tax Rules. Aggrieved by the decision of the Tribunal, the Commissioner filed an application for reference of the above questions to this court and, accordingly, the Tribunal has referred the questions mentioned at the beginning.

4. So far as the first question is concerned, it is concluded by a Full Bench decision of this court in CWT v. Smt. Keathikamal Kumari Varma [1989] 179 ITR 543, wherein it was held that, where the assessee was a partner of a firm and the assets of the firm included agricultural lands, in computing the net wealth of the assessee, the value of the share of the assessee in the agricultural lands was includible in his net wealth and the assessee was entitled to exemption u/s 5(1)(iva) of the Wealth-tax Act, 1957, to the extent of their value up to Rs. 1,50,000. In the light of the above Full Bench decision, the first question has to be answered in the affirmative and in favour of the assessee.

5. We shall now consider question No. 2. u/s 3 of the Wealth-tax Act, wealth-tax shall be charged in respect of the net wealth on the corresponding valuation date of every individual. Hindu undivided family and company at the rate or rates specified in Schedule I. Under the above section, wealth-tax is chargeable on the net wealth. Section 4 provides as to how the net wealth of an individual is to be computed. So far as the interest of the assessee in a partnership firm is concerned, it is provided in Section 4(1)(b) which we shall quote :

"4.(1) In computing the net wealth of an individual, there shall be included, as belonging to that individual--

(b) where the assessee is partner in a firm or a member of an association of persons (not being a co-operative housing society), the value of his interest in the firm or association determined in the prescribed manner."

6. The manner in which the value of the interest of an individual is to be determined is provided for in rule 2 of the Wealth-tax Rules and the relevant portion of the same is extracted below :

"2.(1) The value of the interest of a person in a firm of which he is a partner or an association of persons of which he is a member, shall be determined in the manner provided herein. The net wealth of the firm or the association on the valuation date shall first be determined. That portion of the net wealth of the firm or association as is equal to the amount of its capital shall be allocated among the partners or members in the proportion in which capital has been contributed by them. The residue of the net wealth of the firm or association shall be allocated among the partners or members in accordance with the agreement of partnership or association for the distribution of assets in the event of dissolution of the firm or association, or, in the absence of such agreement, in the proportion in which the partners or members are entitled to share profits. The sum total of the amounts so allocated to a partner or member shall be treated as the value of the interest of that partner or member in the firm or association."

7. From sections 3 and 4 of the Act and rule 2 of the Rules, it is evident that the interest of a partner in a firm is to be valued in accordance with the provisions contained in rule 2. According to that rule, the net wealth of the firm has first to be ascertained as on the valuation date. Thereafter, the same has to be allocated between the partners in the manner indicated in that rule, with which we are not concerned in this case. We are concerned with the question as to how the net wealth of the firm should be determined. Normally, "net wealth" means the real wealth of a person and the real wealth of a person would be the total assets less the debts owed by him. "Net wealth" is defined in Section 2(m)(ii) of the Act. Section 2(m)(ii), so far as it is relevant, reads as follows :

"(m) "net wealth", means the amount by which the aggregate value computed in accordance with the provisions of this Act of all the assets, wherever located, belonging to the assessee on the valuation date, including assets required to be included in his net wealth as on that date under this Act, is in excess of the aggregate value of all the debts owed by the assessee on the valuation date other than,--

(ii) debts which are secured on, or which have been incurred in relation to, any property in respect of which wealth-tax is not chargeable under this Act ;...."

8. Though normally the above liability will also be a debt, a special provision is

made in regard to debts which are charged on properties which are not chargeable under the Wealth-tax Act. The question to be decided is as to whether, in ascertaining the net wealth of the firm, such a debt has to be excluded or not. It is to be remembered that, under the Wealth-tax Act, the firm is not the assessee and the net wealth of a firm is not to be assessed. The assets of the firm are to be determined only to find out the value of the interest of a partner in the firm who alone is the assessee. On a reading of sections 3 and 4 of the Act and rule 2 of the Rules, it is clear to our mind that, in determining the net wealth of the firm, the entire assets and debts of the firm irrespective of any exemption provided for in the Act, so far as an assessee is concerned, have to be taken into account. In *CWT v. Smt. Keathikamal Kumari Varma* [1989] 179 ITR 543, a Full Bench of this court has held that, in valuing the net wealth of the firm, the entire properties including the properties excluded u/s 5 are to be taken into account. So also, the entire debts irrespective of the question whether they are excluded u/s 2(m)(ii) have to be taken into account. In other words, what is provided for under rule 2 is that the net wealth of the firm has to be determined in accordance with commercial principles and all debts owed by a firm of whatever nature and of whatever duration have to be deducted so long as the debts are enforceable against the firm.

9. We are supported in this view by the decision of a Division Bench of the Allahabad High Court in *Commissioner of Wealth Tax Vs. Padampat Singhania*, . In that case, the assessee was a Hindu undivided family which had a one-third share in a partnership. While computing the net wealth of the assessee, it was necessary to take into consideration the assessee's share in the wealth of the firm. A question arose as to whether the outstanding Income Tax liability of the firm was deductible while computing the net wealth of the firm for determining the wealth of the assessee in the light of Section 2(m)(ii) of the Wealth-tax Act. On a consideration of the question, the Division Bench held (at page 421) :

"While determining the net wealth of the firm not for the purpose of assessment, but for the purpose of finding out an assessee's share in it, Sub-clauses (a) and (b) of Clause (iii) of Section 2(m)(ii) would not be applicable. The net wealth under rule 2 is to be determined in accordance with the commercial principles and when so done, all the debts owed by a firm of whatever nature and of whatever duration have to be deducted so long as the debts are legally enforceable against the firm."

10. This decision was followed in *Commissioner of Wealth Tax Vs. Laxmipat Singhania*, and *Seth Satish Kumar Modi v. WTO* [1983] 159 ITR 373 . In the light of the above, we answer question No. 2 in the affirmative and in favour of the assessee.

11. Question No. 3, to some extent, overlaps with question No. 2. Admittedly, there is a debt due from the firm to the Federal Bank charged on agricultural lands. While answering question No. 2, we have held that such a debt has also to be taken into account in valuing the net wealth of the firm. The further question

is as to whether, in valuing the interest of the partner, the loan taken by the firm from the Federal Bank has to be excluded, in view of Section 2(m)(ii) of the Wealth-tax Act. Section 2(m)(ii) provides that, in calculating the net wealth of an assessee, the debts owed by the assessee on the valuation date have also to be deducted. But Clauses (i) to (iii) of Section 2(m)(ii) provide that certain debts are not to be deducted in valuing the net wealth of the assessee. In this case, we are concerned with Sub-clause (ii) which provides that debts which are secured on, or which have been incurred in relation to, any property in respect of which wealth-tax is not chargeable under the Act cannot be taken into account. Counsel for the Revenue contended that u/s 5(1)(iva) as it stood at the relevant time, agricultural lands belonging to the assessee were exempted and that it shall not be included in the net wealth of the assessee. This provision is subject to Section 5(1A) which provides that the exemption in regard to agricultural land as also certain other categories of assets mentioned in Section 5(1) shall be limited to Rs. 1,50,000. It was further contended by him that agricultural land having been exempted which shall not be included in the net wealth of the assessee, the debt in question will squarely come u/s 2(m)(ii) and as such cannot be taken into account. On the other hand, counsel for the assessee contended that what is excluded u/s 2(m)(ii) is only a debt secured or which has been incurred in relation to any property in respect of which wealth-tax is not chargeable under the Act. According to him, agricultural land is also chargeable to wealth-tax under the provisions of the Act, but there is an exemption granted u/s 5(1) read with Section 5(1A) to the extent of Rs. 1,50,000. The question to be considered is as to whether agricultural land is chargeable to wealth-tax or not. On the facts of this case, whether there is any difference between the words "payable" and "chargeable" may not be very relevant. Counsel for the Revenue relied on a Full Bench decision of the Madras High Court in Premier Electro Mechanical Fabricators Vs. The State of Tamil Nadu, , where the court by a majority of two to one held (headnote) :

"That when a debt is secured on several items of properties one of which alone is exempted from wealth-tax, that portion of the debt which is attributable to the value of the property exempted from wealth-tax cannot be deducted in the computation of the net wealth of the assessee. Similarly, when a debt is secured or acquired in relation to a property which is only partially exempted from wealth-tax, that portion of the debt which is attributable to the portion of the property exempted from wealth-tax cannot be deducted in the computation of the net wealth of the assessee.

The rule of strict construction applies only to charging sections and not to machinery sections. Section 2(m)(ii) of the Wealth-tax Act, 1957, is not a charging section and the rule of strict construction cannot be applied to it. The principle of "purposive construction" has to be applied. This is a construction which will promote the general legislative purpose underlying the provision. Section 2(m)(ii) speaks of debts which are secured on or which have been incurred in relation to any property in respect of which wealth-tax is not

chargeable under the Act. In cases where an asset is only partially exempt from chargeability to wealth-tax, then it must necessarily follow that the portion of the debt secured on such portion of the asset or incurred in acquiring such portion of the asset has to be excluded from reckoning. This construction will be in harmony with the scheme and purpose of the Wealth-tax Act."

12. Balasubrahmanyam J., in his dissenting judgment, however, held (headnote) :

"Section 2(m)(ii) does not speak of exempted assets. It only refers to property in respect of which wealth-tax is not chargeable. This phrase must be understood as meaning "property in respect of which wealth-tax is not at all chargeable". "Not at all" is not a gloss. It is very much a part of the meaning. If the secured properties fit in with the meaning of Section 2(m)(ii), the connected debts go out of the reckoning. But if the properties are not comprehended by Section 2(m)(ii), the general rule of deducibility operates, and this general rule knows no restrictions. In other words, depending on its relation to the asset in question, a debt is either deductible or not deductible. Section 2(m)(ii) does not contain any provision for partial abatement, or apportionment, of a debt under which part of it is deductible and part of it is not. On the words of Section 2(m)(ii), once an asset which secures the debt is treated as an asset on which wealth-tax is chargeable, even though a part of the value of the asset is exempt from tax, the whole of the secured debt must be deducted."

13. On the other hand, counsel for the assessee relied on a Division Bench decision of the Bombay High Court in Commissioner of Wealth-tax Vs. Vasantkumar Govindji Kotak, , wherein the dissenting judgment of the learned single judge of the Madras High Court in the aforesaid decision was followed.

14. We have considered the above judgments as also the relevant statutory provisions. The language of the provision contained in Section 2(m)(ii) is clear and the said provision will apply only if the debt is secured on or incurred in relation to any property in respect of which wealth-tax is not chargeable under the Act. So the question to be decided is as to whether the agricultural land is chargeable to wealth-tax under the Act or not. By virtue of Section 4 of the Act, in computing the net wealth of an assessee, the value of all the assets of the assessee has to be taken into account. But Section 5(1) provides for certain exemptions in respect of certain assets including agricultural lands as provided in Sub-clause (iva) thereof. But it is to be noted that this exemption is further limited by the provisions contained in Section 5(1A) to an aggregate of Rs. 1,50,000. It can thus be seen that agricultural lands are not fully exempt but only to the extent of what is provided for in Section 5(1A). In other words, only a part of the value of the property is exempt. By that itself, it cannot be said that the property as such is not chargeable to wealth-tax. Agricultural land is chargeable to wealth-tax, but a portion of the same is exempt in the light of the provisions contained in Section 5(1) and Section 5(1A). There is no provision for apportioning the liability in the Act or in the Rules. Moreover, the exemption to the extent of Rs. 1,50,000 provided for in Section 5(1A) is not exclusively for

agricultural lands. A reading of Section 5(1A) shows that the aggregate exemption of Rs. 1,50,000 is in regard to agricultural lands and other types of assets mentioned in Section 5(1A). If an assessee owns agricultural lands as also other assets mentioned in Section 5(1A), how the total amount of exemption of Rs. 1,50,000 is to be apportioned among the different types of assets is not indicated in the Act or in the Rules. This also is an added ground for us to hold that it cannot be said that agricultural land is not chargeable to wealth-tax. Therefore, it follows that the debt in question with which we are concerned is not incurred in relation to a property which is not chargeable to wealth-tax. With respect, we are in agreement with the view expressed by Balasubrahmanyam J., in his dissenting judgment in the Full Bench case of the Madras High Court in Premier Electro Mechanical Fabricators Vs. The State of Tamil Nadu, and the view expressed by the Bombay High Court in Commissioner of Wealth-tax Vs. Vasantkumar Govindji Kotak, Accordingly, we answer question No. 3 in the affirmative and in favour of the assessee.

15. In view of what is stated above, we answer questions Nos. 1 to 3 in the affirmative and in favour of the assessee. There will be no order as to costs.

16. A copy of this judgment under the seal of this court and the signature of the Registrar shall be sent to the Income Tax Appellate Tribunal, Cochin Bench.