
(1994) 11 KL CK 0016

In the High Court Of Kerala

Case No : Income-tax Reference No. 521 of 1985

K.V. Idiculla

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 23-11-1994

Acts Referred:

Income Tax Act, 1961 — Section 45, 48, 49, 49(1), 55

Citation : (1995) 214 ITR 386

Hon'ble Judges : T.L. Viswanatha Iyer, J;K.K. Usha, J

Bench : Division Bench

Advocate : G. Sivarajan, for the Appellant; P.K.R. Menon, Senior Advocate and N.R.K. Nair, for the Respondent

Judgement

T.L. Viswanatha Iyer, J.—The following questions have been referred at the instance of the assessee :

"1. Whether, on the facts and in the circumstances of the case, the tribunal was right in holding that for the purpose of computing the capital gains arising out of the sale of the property the full value of the consideration received by the assessee should be taken as Rs. 83,000 and not Rs. 5,544 ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the sum of Rs. 78,156, which was adjusted out of the sale consideration against the liabilities charged on the property inherited by the assessee, did not constitute cost of acquisition for the purpose of Section 48 of the Income Tax Act, 1961 ?

3. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that there was no diversion at source by overriding title to the extent of Rs. 78,156 which was adjusted from out of the sale consideration against the liabilities charged on the property inherited by the assessee?"

2. The dispute between the parties centres on the assessment of an amount of Rs. 32,700 as the capital gains arising out of the transfer of a land with building,

having an extent of 47.5 cents, to the assessee's wife. The assessment year concerned is 1980-81 corresponding to the accounting period ending March 31, 1980. This property belonged to the assessee's father, one K.I. Varkey, who had purchased it on June 16, 1964. He was an authorised dealer in rationed articles. The assessee's wife had received sthreedhanam which was invested in her father-in-law Varkey's business, in which she had a credit balance of Rs. 73,570 as on December 31, 1978. Varkey executed a will on August 23, 1979, bequeathing this property to his son, the assessee, directing that the amount due to the assessee's wife should be paid out of this property. After Varkey's death on September 30, 1979, the assessee transferred the property to his wife by two documents dated October 15 and 22, 1979, for a consideration of Rs. 83,700. In the return filed by him for the assessment year 1980-81, the assessee declared a capital gain of Rs. 5,544 claiming, inter alia, that he had effected improvements to the property to the extent of Rs. 49,047. The Income Tax Officer adopted the amount of Rs. 83,700 as the full value of the consideration, from which he deducted Rs. 21,000 as the cost of acquisition, being the amount for which Varkey purchased the property on June 16, 1964, as also an amount of Rs. 20,000 as cost of improvements as against Rs. 49,047 claimed. He thus brought to tax an amount of Rs. 42,700 as capital gains. This was confirmed in appeal by the Appellate Assistant Commissioner and also by the Tribunal, subject to an enhancement by the Tribunal, of the cost of improvements from Rs. 20,000 to Rs. 30,000. At the assessee's instance, the aforesaid questions have been referred for the opinion of this court u/s 256(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act").

3. Inter alia, it had been held by the Appellate Assistant Commissioner that under the terms of Varkey's will, there was a specific charge on the property transferred for the amount due to the assessee's wife. The first contention of the assessee before us is, therefore, that the full value of the consideration for the purpose of Section 48 is not the amount of Rs. 83,700 recited in the documents as the consideration, but the said amount as reduced by the amount covered by the charge in favour of the assessee's wife. The contention is that there is a diversion by overriding title, at source and, therefore, the amount covered by the charge did not reach the assessee as his income, but stood diverted even earlier. We are unable to agree with this contention. In *The Commissioner of Income Tax, Bombay City II Vs. Shri Sitaldas Tirathdas*, , the Supreme Court had occasion to consider as to what constitutes diversion by overriding title. In that case, maintenance was payable to the wife and children of the assessee pursuant to a decree, which was not however made a charge on the property of the assessee. The Supreme Court held that there was no diversion of income by overriding title, and, therefore, the amount paid as maintenance was not liable to be deducted in the computation of the assessee's income. The true test, the Supreme Court observed, is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Where by virtue of the obligation, income is diverted before it reaches the assessee, it is deductible. But where the

income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence does not follow. It is only the first kind of payment which can truly be excused and not the second. It was accordingly held that the case was only one of application of a portion of the income to discharge an obligation and not one in which by an overriding charge, the assessee became only a collector of another's income.

4. These principles were reiterated by the Supreme Court in *Moti Lal Chhadami Lal Jain Vs. Commissioner of Income Tax, Delhi*, , where the arrangement between a lessor and lessee was that the lessee should pay part of the total rent to a college run by a trust, with a right given to the college to recover the amount directly from the lessee. This right of the college was made a charge on the property by agreement between the parties, and the question was whether the amount paid over to the college could be treated as the income of the assessee, the plea being that the amount got diverted by overriding title to the college and ceased to be the assessee's income. The Supreme Court negated the contention affirming what they had stated in *The Commissioner of Income Tax, Bombay City II Vs. Shri Sitaldas Tirathdas*, . The court observed that the emphasis was on the nature of the obligation by reason of which the income becomes payable to a person other than the one entitled to it. Where the obligation flows out of an independent title in the former (such as the rights of dependants to maintenance or of coparceners on partition, or rights under a statutory provision or an obligation by a third party and the like), it effectively slices away a part of the corpus of the right of the latter to receive the entire income and so, it would be a case of diversion. On the other hand, where the obligation is self-imposed or gratuitous, it is only a case of application of income.

5. In our view, the case on hand falls under the latter clause where the obligation is self-imposed, apart from its being only an application of the consideration received by the assessee. There is no case that the assessee's wife had sought any charge on the property for the amount due to her. At best, what the deceased Varkey did was only to ensure that the assessee's wife got her money, with an expression that it may be a charge on the property. It was only an obligation to pay a debt created by himself (in this case, Varkey), and an application of the consideration for discharge of the debt. The payment of the debt was not made by virtue of any overriding obligation to make payment of it, but was just the discharge of an obligation created by Varkey himself in favour of his daughter-in-law. This is a case of an application of the sale price after it reaches the assessee, and not a diversion at source before it reaches the assessee. The full value of the consideration has therefore to be taken as Rs. 83,700, and not that amount less the amount due to the assessee's wife.

6. The next contention raised is that the assessee had inherited the property under the will subject to the charge and, therefore, the amount of the liability to the wife should be deducted in the computation of the capital gains. The decision in *Ambat Echukutty Menon Vs. Commissioner of Income Tax, Kerala*, which had

held to the contrary was stated to lay down the law incorrectly, thereby requiring reconsideration.

7. Before we deal with this point, we may briefly advert to the provisions related to the levy of capital gains. Section 45 provides that any profits or gains arising from the transfer of a capital asset effected in the previous year shall, subject to certain exemptions and deductions, be chargeable to Income Tax as capital gains, and shall be deemed to be the income of the previous year in which the transfer took place. Section 48 lays down the mode of computation of the capital gains, and the deductions to be made. It states 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, the amounts mentioned, which include the cost of acquisition, of the capital asset, and the cost of any improvement thereto. We are not concerned with other items. Section 55 defines what is "cost of improvement" and what is "cost of acquisition". Cost of improvement, so far as is relevant, means expenditure of a capital nature incurred in making any additions or alterations to the capital asset by an assessee after it became his property, and in the case of assets which became the property of the assessee by any of the modes specified in Sub-section (1) of Section 49, by the previous owner. Sub-section (2) defines what is meant by cost of acquisition for the purpose of Sections 48 and 49. Section 49 to which reference is made in both these definitions, deals with cost with reference to certain modes of acquisition. One of the modes of acquisition, which is relevant for the purpose of this case, is where the capital asset became the property of the assessee under a gift or will. The section provides that in such cases the cost of acquisition of the asset shall be deemed to be the cost for 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.

8. In *Ambat Echukutty Menon Vs. Commissioner of Income Tax, Kerala*, a property acquired by one Padmanabha Menon was divided among his heirs including the assessee, who got a one-fifth share therein. The property had been mortgaged by Padmanabha Menon during his lifetime, and his heirs discharged the mortgage after his death by paying an amount of Rs. 58,643. The property was acquired under the Land Acquisition Act. The assessee claimed that in computing the capital gains arising on the acquisition, the one-fifth share of the mortgage amount which was paid by the heirs, and which fell to his share should be deducted. The case was one which fell u/s 49(1) of the Act. The Bench, therefore, held that the cost of acquisition of the asset was the cost for which the previous owner Padmanabha Menon acquired it. So far as the cost of improvement was concerned, the Bench held that the expenditure should have been incurred in making any additions or alterations to the capital asset that was originally acquired by the previous owner. When the previous owner had mortgaged the property, and his heirs cleared off only that mortgage, it could not be said that they had incurred any expenditure by way of effecting any

improvement to the capital asset that was originally purchased by the previous owner. The assessee's claim for deduction of his share of the mortgage amount was thus negatived.

9. Counsel for the assessee strongly urges for a reconsideration of this decision in the light of the decision of the Gujarat High Court in *Commissioner of Income Tax Vs. Daksha Ramanlal*, , as also by relying on the criticism of the decision in *Ambat Echukutty Menon Vs. Commissioner of Income Tax, Kerala*, by Kanga and Palkhiwala at page 781 of the Eighth edition of the *Law and Practice of Income Tax*. The Gujarat High Court dissented from *Ambat Echukutty Menon Vs. Commissioner of Income Tax, Kerala*, as also the decisions of the Madras High Court in *Commissioner of Income Tax Vs. V. Indira*, and *S. Valliammai and Another Vs. Commissioner of Income Tax, Madras*, . The view taken by the Gujarat High Court is that when the previous owner gifted the mortgaged property to the assessee, what he had transferred was the right, title or interest which he had in that property. When the assessee discharged the mortgage, what he did was to purchase that right or interest which the mortgagor did not then, possess, and which the mortgagee had in that property. The word "property" does not mean merely physical property, but also any right, title or interest in it. In the case of a mortgage or lease, different persons will have different rights in the same 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. He transfers only those rights which he possesses, and the transferee gets the property subject to the rights created by the previous owner. Therefore, when the assessee sold the property after discharging the mortgage, she sold not merely the right, title or interest, which she received from, the owner, but also the right, title or interest she had purchased from the mortgagee. The case would not therefore be covered by Section 48(1)(ii) or by Section 55(2)(ii), but 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(1). In either case, the amount spent for discharging the mortgage was part of the cost of acquisition and, therefore, it had to be taken into account for the purpose of computing the total cost of acquisition of the property, in the computation of the capital gains.

10. The learned authors, Kanga and Palkhivala, have criticised the decision in *Ambat Echukutty Menon Vs. Commissioner of Income Tax, Kerala*, on more or less the same lines as in the Gujarat High Court decision observing, *inter alia*, that what the assessee inherited was only the mortgagor's title, which he enlarged by extinguishing the mortgagee's title. The two separate costs of the two titles constitute in the aggregate the cost of acquisition for the purpose of computing the capital gains.

11. The scheme of Sections 48, 49 and 55 is clear. Being a statute imposing tax, we must go by what is provided therein. Section 48 lays down the mode of computation of capital gains, and the deductions to be made therefrom, namely,

the expenditure incurred wholly and exclusively in connection with the transfer, the cost of acquisition of the asset and the cost of any improvement thereto. No other deductions are provided. (Commissioner of Income Tax, Tamil Nadu-II Vs. A. Venkataraman and Others, This court in Ambat Echukutty Menon Vs. Commissioner of Income Tax, Kerala, had proceeded on the basis that the cost of acquisition in a case falling under Sub-section (1) of Section 49 is relegated to the cost of the previous owner, in this case Varkey. We do not find any reason to take a different view. The sub-section is categorical that the cost of acquisition in the case of an asset which became the property of the assessee in any of the modes prescribed therein is deemed to be that for which the previous owner acquired it. This is a fiction created by that sub-section which has to be given its full effect. The lives of the assessee and the previous owner are combined for this purpose and the cost is related back to that at which the previous owner acquired the asset. The only addition to be made is the cost of any improvement effected to the asset by either the previous owner or the assessee, with which we shall deal later. But so far as the cost of acquisition, pure and simple, is concerned, it is only that at which the previous owner acquired it and not anything more. It must be noted that the asset which is dealt with in Section 49 is the entire bundle of rights constituting the asset as acquired by the previous owner, and not merely that bundle less the rights of the mortgagee, under the mortgage created by him. This, in our opinion, is clear from the section, because it speaks, of the cost of the asset to the previous owner, which implies that the asset referred to is the entire bundle of rights acquired by the previous owner. We are, therefore, unable to agree with the Gujarat High Court, or to uphold the assessee's contention that the cost of acquisition is the cost of acquisition of the previous owner plus the amount spent on the discharge of the mortgage on the property, created by the previous owner.

12. This position was correctly understood in Ambat Echukutty Menon Vs. Commissioner of Income Tax, Kerala, , where the Bench observed that the cost of acquisition of the asset is, by virtue of the fiction created by Sub-section (1) of Section 49, the cost to the previous owner without adding the mortgage amount thereto. We must point out that the same view was taken by the High Court of Madras in Commissioner of Income Tax Vs. V. Indira, . In that case, the assessee's father gifted a house property to her, in respect of which she paid a sum of Rs. 6,943 under a compromise suit claiming title to a portion of the land, and claimed deduction of the amount in computing the capital gains. The court held that this amount did not form part of the cost to the previous owner and, therefore, could not qualify for deduction as cost of acquisition of the property. The Bench pointed out that if the amount had been paid by the previous owner himself rather than by the assessee, then perhaps the amount would have been deductible in the hands of the assessee as the cost of acquisition of the asset to the previous owner.

13. The next question for consideration is whether the payment of the amount of the charge to the assessee's wife is an improvement to the property effected by

the assessee and, therefore, deductible in the computation of the capital gains. In *Ambat Echukutty Menon Vs. Commissioner of Income Tax, Kerala*, , this court had held that discharge of a mortgage created on the property by the "previous owner" could not be treated as an improvement to the capital asset which originally became the property of the previous owner, expenditure on which was liable to be deducted as cost of improvement. The same view was echoed by the Madras High Court in *Commissioner of Income Tax Vs. V. Indira*, referred to earlier, with an added reason that the improvement, the cost of which is liable to be deducted, should be an improvement to the asset itself, and not an improvement of the owner's title to the asset. The Madras High Court stressed on the word "thereto" to hold that improvement of the owner's title to the asset is different from improving the asset itself.

14. The decision in *Commissioner of Income Tax Vs. C.V. Soundararajan and Another*, , relied on by counsel for the assessee, is distinguishable on the facts. In that case, the mother who was paid off had an anterior right of residence. That right of residence was got discharged by payment of Rs. 60,000, and accordingly it was held that the amount was deductible in the computation of the capital gains. That certainly is not the position so far as discharge of a mortgage created by the previous owner, in a case covered by Section 49(1), is concerned.

15. We are in agreement with the view expressed in *Ambat Echukutty Menon Vs. Commissioner of Income Tax, Kerala*, on both the aspects of cost of acquisition and cost of improvement and do not find any ground for reconsideration of the decision.

16. The amount due to the assessee's wife is not therefore liable to be taken note of in computing the capital gains arising on sale of the property.

17. Sri G. Sivarajan for the assessee contended that the assessee is put to hardship by being called upon to pay tax on the capital gains. Assuming it is so, that is not a ground for reading the section in a different way.

18. We are, therefore, in agreement with the Tribunal on the questions raised. The questions referred are accordingly answered against the assessee and in favour of the Revenue.

19. There will be no order as to costs.

20. Communicate a copy of this judgment under the seal of this court and the signature of the Registrar to the Income Tax Appellate Tribunal, Cochin Bench, for information.