(1987) 07 KL CK 0031

In the High Court Of Kerala

Case No : Income Tax R. No''s. 20, 233 to 235 and 268 of 1981 (1982 ?)

Parthas Trust APPELLANT

Vs

Commissioner of Income Tax RESPONDENT

Date of Decision : 29-07-1987

Acts Referred:

Income Tax Act, 1961 — Section 32
Transfer of Property Act, 1882 — Section 53A
Trusts Act, 1882 — Section 7

Citation : (1988) 1 ILR (Ker) 1 : (1988) 169 ITR 334

Hon'ble Judges : P.K. Shamsuddin, J;P.C. Balakrishna Menon, J;K. Sukumaran, J

Bench : Full Bench

Advocate : G. Sivarajan, for the Appellant; P.K.R. Menon, for the Respondent

Judgement

K. Sukumakan, J.—Trusts have fought pitched battles in the tax fields. The law reports present pictures of many such fights between the assessee and the Revenue. Authoritative text books on trusts or charities now devote substantial space for discussion of taxation problems of the trust. Underbill notes :

" The law relating to a trustee''s liability for such taxes is so massive and detailed that examination of these matters should proceed from the standard works on the various taxes. " (See Under hill''s Law of Trusts and Trustees, thirteenth edn., by David J. Hayton at page 358).

2. Yet at page 398, that book itself provides a topic " Tax Avoidance " and states :

"The question how far the necessary benefit, if financial, may be obtained at the expense of the revenue--how far, in other words, the court will approve arrangements solely or principally designed to save tax --is in some respects a difficult one. "

3. Settlement Trusts of Chapman (No. 2) [1959] 2 All ER 47 , Drewe [1966] 2 All ER 844 (Ch D), Lloyd [1967] 2 All ER 314, Clitheroe''s [1959] 3 All ER 789 , Cohen''s [1959] 3 All ER 523 , Sainsbury* [1967] 1 All ER 878 , Lister''s [1962]

3 All ER 737 , Van Gruisen''s [1964] 1 All ER 843 and Zekelman [1971] 19 DLR 652 ; have all been discussed there at some length. Philip H. Pettit in " Equity and the Law of Trusts" deals with trusts and taxation under a separate topic. The discussion starts with the sentence:

" With taxation at present level, it is obvious that revenue considerations are in practice commonly of vital importance in trust matters, particularly perhaps when the creation of a trust is under consideration." (See " Equity and the Law of Trusts " by Philip H. Pettit at page 19).

4. " The Taxation of a Trust " is a separate chapter in the book " The Modern Law of Trusts " by David B. Parker and Anthony R. Mellows. In India too, a specialised publication is available : " Tax Planning for Public and Private Trusts " by Dr. Paras Diwan and B. K. Diwan.

5. The last two decades witnessed a spurt in the " trust " litigation in this court. Conflicting views on very many facets of trusts and their functioning sometimes appear in decided cases : DHARMODAYAM CO. Vs. COMMISSIONER OF Income Tax, KERALA., , Commissioner of Income Tax Vs. Shri Shaila Industrial and Spiritual Colony Charities, , Commissioner of Income Tax Vs. Dharmadeepti, , Commissioner of Income Tax Vs. Vanchi Trust and Another, , Commissioner of Income Tax Vs. V.S. Kumaraswamy Reddiar Trust, , Commissioner of Income Tax Kerala and Coimbatore Vs. Krishna Warriar, and Indian Chamber of Commerce Vs. Commissioner of Income Tax , West Bengal II, Calcutta, are some of the important'' decisions on the topic during this period. Some of the complexities of the problem have been referred to in Commissioner of Income Tax, Kerala Vs. Dharmodayam Co., .

6. Even in relation to the validity of a trust, there have been quite a few decided cases of this court in recent years. Commissioner of Income Tax Vs. V.S. Kumaraswamy Reddiar Trust, , Commissioner of Income Tax Vs. T.A.V. Trust, and Commissioner of Income Tax Vs. Seematti Trust, are only some such recent cases. The decisions rendered in similar cases would only be helpful guides and not binding directives. It is obvious that the validity of a trust would essentially be dependent upon facts and materials which have a bearing on the origin and constitution of that trust.

7. The legal validity of one such trust--the Parthas Trust--arises in these references.

8. Parthas Trust was constituted by an indenture dated August 4, 1971. J. Ramachandr Ammal figured therein as the founder. There were four trustees and 28 beneficiaries. The parties were intimately connected with two trading firms, Parthas Textiles, Kottayam, and Parthas Textiles at Attingal.

9. The business of the firms was taken over by the trust under subsequent agreements. The agreement dated August 17, 1971, concerned immovable properties. Possession of the immovable properties was delivered to the trust. No

sale deed, however, had been executed as regards those properties.

10. The trust had its first assessment under the Income Tax Act, 1961 (hereinafter referred to as "the Act"), during the assessment year 1972-73. A fundamental and serious question arose for consideration and decision : about the existence of a valid trust.

11. The Income Tax Officer took the view that there was no duly executed instrument in writing as contemplated u/s 160(1)(iv) of the Act and, consequently, the advantageous assessment u/s 161 would not be available. The Appellate Assistant Commissioner took a different view. According to him, there was a valid trust. The Tribunal affirmed that conclusion. The Revenue took up the matter before this court.

12. In the meantime, assessments were made in respect of later years as well. Against the adverse decisions of those years also, the Revenue took up the issue for a decision by this court. ITR Nos. 84 to 86 and 125 of 1979 and 71 to 77 of 1981, thus came up for hearing before this court (see Appendix infra p. 348). (We do not consider question No. 1 in ITR No. 20 of 1982, as it was not pressed).

13. A Division Bench of this court consisting of K. Bhaskaran, Actg, C.J. and M. P. Menon J. by judgment dated October 12, 1984 (see Appendix infra p. 348), considered the question. The reference was answered in favour of the assessee and against the Department.

14. Three reasons which had been urged for turning down the claim of the assessee for an assessment u/s 160(1)(iv) were referred to in paragraph 5 of the judgment as (at p. 351):

" (i) the founder had no property to be transferred to the trust;

(ii) the properties of the minors had been made the subject-matter of the trust without satisfying the conditions of Section 7(b) of the Trusts Act; and

(iii) the immovable properties have been made the subject-matter of the trust without a valid transfer. "

15. This court recapitulated the findings of the Appellate Assistant Commissioner that the trust deed, considered as a whole, did not indicate the minors as the authors of the trust, that the immovable properties were not the subject-matter of the trust, and that Sections 5 and 6 of the Indian" Trusts Act, 1882, had been satisfied. It also adverted to the affirmance of those reasons by the Appellate Tribunal.

16. This court took the view that on August 3, 1971, a sum of Rs. 1,40,000 was available with the founder of the trust by contribution from the two firms and that the sums had become her property before the trust deed came into existence on August 4, 1971. The question whether the property which belonged to the minors had been transferred by the guardians without obtaining the permission of the principal civil court, and consequently violating Section 7(b) of

the Trusts Act, was also considered by this court. It was held that the contention about the invalidity of the trust based on an evaluation of Section 7(b) was untenable, inasmuch as the funds were made available by the majors and no contribution was made to the funds of the trust by the minors themselves, (emphasis* supplied). The court, among others, referred to the journal entries which showed that "the contributions to the corpus of the trust fund so far as the minors were concerned, were made by the majors... " As a matter of fact, on this aspect, even the Income Tax Officer who turned down the claim of the assessee found that the submissions made on behalf of the assessee about the transfer of funds as disclosed in the journal entries were correct. The Division Bench quoted the following passage from the order of the Income Tax Officer (at p, 352);

" In the reply, it is submitted that the minors have not transferred the property. It is further represented that the majors have transferred property to the trust for the minors with the specific direction that the funds are transferred to the corpus of the trust. He also represented that Smt. Ramachandru Ammal has transferred sums in respect of her two minor children, K. L. Sivakumar and K. L. Indumathy. In support of the assessee''s claim, he filed copies of journal entries by which the transfer entries to the corpus of the trust were made. These journal entries filed were verified by me with reference to the books produced and are found correct. "

17. In reaching the ultimate conclusion, the Division Bench referred to an earlier decision of this court in Commissioner of Income Tax Vs. V.S. Kumaraswamy Reddiar Trust, , wherein the court had to consider the validity of a trust with somewhat similar features.

18. We do not find any reason whatever to differ from the factual findings as reached by this court in relation to the very same assessee and the very same trust deed for the preceding years. Whether the founder had property with her to constitute a trust and whether the transfer of funds had been made by the majors as contended by the assessee or on behalf of the minors by their guardians, were questions of fact. This court, on an exhaustive and clear analysis of the materials before it, entered the finding that the author of the trust had the necessary funds for constituting the trust and that the contributions came not from the minors but from the major members of the two firms. As noted earlier, this conclusion was in conformity with the findings of the Appellate Assistant Commissioner and the Appellate Tribunal. The ultimate conclusion that a valid trust came into being, frased on the above findings, does not call for any variation whatever for the subsequent years as well. We have no hesitation in confirming similar findings of the Tribunal for the later years. The first question :

" Whether, the trust has been created by a duly executed instrument in writing and whether there is any representative assessee within the meaning of Section 160(1)(iv) of the Income Tax Act, 1961 ? "

has, therefore, to be answered in the affirmative, in favour of the assessee and against the Revenue. We do so.

19. This batch of cases happened to be posted before the Full Bench, when a Division Bench (Kochu Thommen and Radhakrishna Menon JJ.) felt that the earlier decision in Commissioner of Income Tax Vs. Seematti Trust, , on the self-same question, was in conflict with the view expressed in some later cases decided by a different Bench of this court in CIT v. Parthas Trust (see Appendix infra p. 348). The Division Bench observed :

" Identical clauses are contained in the deed in question in the present cases."

20. With great respect, we feel that this assumption is unjustified. A perusal of the judgments in the two cases would demonstrate the striking differences on factual matters as involved in the two sets of cases. If identical questions had been involved in the decision considered by the Division Bench of this court in Commissioner of Income Tax Vs. Seematti Trust, , doubtless, propriety would have demanded a reference to a Full Bench. The Division Bench which decided Seematti Trust''s case obviously did not feel it necessary to do so. This can be understood only on the basis that the facts of the decision of this court in Parthas Trust''s case (see Appendix infra p. 348), did not have any similarity with those in Commissioner of Income Tax Vs. Seematti Trust, . As indicated earlier, we do not, in this case, find any reason whatever to take a view different from the one expressed in respect of the self-same trust in the earlier Division Bench decision of this court.

21. The second question relates to deduction in the computation of income claimed in relation to the depreciation on the immovable proper-ties which the trust obtained under the agreement dated August 17, 1971.

22. The possessory right under the agreement coupled with the use thereof, it is claimed, makes the assessee eligible to the deduction. The assessee drew inspiration and support from a decision of the Allahabad High Court in Additional Commissioner of Income Tax Vs. U.P. State Agro Industrial Corporation Ltd., . The assessing authorities, however, did not readily grant the claim of the assessee. Ultimately, the claims involved in the appeals of different years reached the Tribunal, demanding a decision. It so transpired that one set of appeals came before one Bench of the Tribunal and another batch came before another Bench. The two Benches of the Tribunal have, however, talked in two different voices. The Bench, which dealt with appeal I. A. Nos. 157, 158, and 271 (Coch) of 1980 took a view in favour of the assessee. The contrary view was expressed by the other Bench while disposing of the other appeals.

23. It may straightaway be noticed that the question has now been considered by other High Courts also. The Allahabad and Patna High Courts are the forts sheltering a theoretical thought which would give support and sustenance to the contention put forward by the assessee. All other High Courts have arrayed themselves on the other side. It is not by mere counting of numbers that victory is declared in intellectual fights. Much depends upon the mettle of the reasoning

and the deployment of the projected logic.

24. It is useful to start reading that portion of the section of the Act before any discussion is attempted.

"32. Depreciation.--(1) In respect of depreciation of buildings, machinery, plant or furniture owned by the assessee and used for the purposes of the business or profession, the following deductions shall....... be allowed--"

25. Under this section, depreciation is claimable by an owner of the asset and who uses the asset in question. Both the conditions, ownership and use, have to be satisfied.

26. Each of these terms--"ownership " and " use "--would receive much content and colour from the context in which it is used. The background of the statutory scheme would facilitate the search for the correct answer. It would shed light along the path as to the proper direction and ultimate destination.

27. The totality of the phrase as occurring in the section will have to be considered lest much vitality and significance should be missed. That was the caution given by Lord Scarman in a recent case, South West Water Authority v. Rumble''s [1985] 1 All ER 513 (HL).

28. The term " owner" no doubt is an ordinary English word. As observed by Lord Scarman, there are many " ordinary English words which possess by their very imprecision the flexibility which is the hallmark of the English language, and which is one of the reasons for the survival of English as a living and worldwide tongue ". The decisions dealing with the question have indicated the range of flexibility in some appreciable measure, (vide [1985] 1 All ER 513). "Owner" may signify differently in different contexts.

29. " Depreciation " allowance was a concession granted by the State in the computation of income based on very many factors relevant to a wholesome fiscal administration. A booming industrial enterprise is essential for the generation of other economic activities. It is in the ebbtide of economic and industrial adventures that the State could cast its taxing net wide and deep. It is pointless and profitless from the tax-gatherers'' point of view to be a lonely angler. The State needs much more than what would satiate the sportive curiosity of a leisure-seeking holiday man. Enterpreneurial development is, therefore, to be encouraged. Incentives to those who own and use assets of appreciable value is essential to encourage such business ventures. When this is the basic idea, the essential ingredients of a claim for depreciation and for other allowances geared to the use of business assets could be easily identified. These deductions cannot be claimed by someone without any real connection with the asset, someone having only some nominal or casual connection. The claimant must be one with much more than some threads of rights. What is needed is a well-woven garment of ownership ; not some or a few slender threads somehow gathered. Again, the section would not grant depreciation allowance to a person

merely for the reason that he owns it. The user of the asset in the income-generating enterprise is equally essential.

30. Are the twin requirements satisfactorily complied with in the present case ?-- should be the question to be posed before the deduction under this head is conceded. The full ownership postulated on the part of a claimant has added relevance and significance in that context.

31. It is unnecessary to traverse areas with which the case in hand is not directly concerned. The short question is whether a person who had not obtained a sale deed itself, could be treated as an owner for the purposes of Section 32.

32. It is profitable to bear in mind in that context that tax laws do not stand in isolation from the general law of the country. The laws of the country, viz., the Transfer of Property Act and the Registration Act, would certainly insist on a document in writing, and duly registered, for the recognition of a transfer of title to immovable property, of the value of over Rs. 100. A mere agreement of sale will not do duty for a proper sale deed duly executed. The content of Section 32 of the Income Tax Act would not clothe with ownership a mere possessor of some beneficial interest. Section 53A of the Transfer of Property Act, 1882, which only furnished an equipment of enquiry is not effective enough for the acquisition of title or obtaining of the ownership. When such a vital condition regarding the ownership of the asset is not satisfied, the claim for deduction is bound to be rejected. This, according to us, is the correct view to be taken in relation to the claim for deduction under the head of depreciation.

33. The scope of Section 54 of the Transfer of Property Act, 1882, and Sections 17 and 47 of the Registration Act, 1908, has been discussed in the context of ordinary civil suits. Some of these important decisions of the Supreme Court are : Radhakisan Laxminarayan Toshniwal Vs. Shridhar Ramchandra Alshi and Others, , Ram Saran Lall and Others Vs. Mst. Domini Kuer and Others, and Hiralal Agrawal etc. Vs. Rampadarath Singh and Others, etc., . Section 47 of the Registration Act permits a document, when registered, to operate from a date which may be anterior to the date of registration but that has nothing to do with the completion of sale when the instrument is one of sale. That appears to be one of the emerging principles. Even in other contexts, a similar approach had been indicated by the High Courts. (See Commissioner of Income Tax Vs. Bhurangya Coal Co., , Commissioner of Income Tax Vs. Ganga Properties Ltd., , Commissioner of Income Tax Vs. Hindustan Cold Storage and Refrigeration P. Ltd., , Amarchand J. Agarwal Vs. Union of India and others, , Amarchand Jainarain Agarwal Vs. Union of India and others, and Raja Sir M.A. Mutthiah Chettiar Vs. Commissioner of Income Tax, Madras, . Even in the context of a claim for depreciation u/s 10(2)(vi) of the Indian Income Tax Act, 1922 (which corresponds to the present Section 34), the Delhi and Bombay High Courts have taken the view that in the absence of a registered sale deed, a claim for depreciation has to fail by reason of non-satisfaction of one of the pre-conditions. These decisions have been surveyed exhaustively in a very recent decision (very

recent from the point of view of reporting ; it was rendered on April 17, 1984) by the Madras High Court in Commissioner of Income Tax Vs. Sivanandha Mills Limited, , by Ramanujam and Ratnam JJ. With great respect, we are in agreement with the analysis, approach and conclusion as indicated in that decision. We agree with -that High Court that the contrary views taken by the High Courts of Allahabad and Patna in Additional Commissioner of Income Tax Vs. U.P. State Agro Industrial Corporation Ltd., and Addl. Commissioner of Income Tax Vs. Sahay Properties and Investment Co. (P.) Ltd., do not lay down the correct law. Our entire agreement with the lucid reasoning of the Madras High Court in Commissioner of Income Tax Vs. Sivanandha Mills Limited, , justifies the reproduction of the following extract from that judgment (at, pages 70 and 71):

" The use of the expression '' owned by the assessee and used for the purpose of business or profession'' emphasises that it is not mere user irrespective of ownership that is contemplated by Section 32 as a necessary condition for claiming the allowance of depreciation. Such ownership must necessarily mean legal title to the asset in the assessee and the user thereof by the assessee while being such owner in the course of the business of the assessee. Otherwise, as pointed out earlier, any person inclusive of a person who is not, in any manner, entitled to be in possession of the property, can get into possession and then claim that he is in possession of the property in his own right to the exclusion of others and, therefore, he should be deemed to be the '' owner '' for all purposes, inclusive of Section 32 of the Act. We are unable to subscribe to such an interpretation of Section 32 of the Act, as, in our view, that would strike at the root of and negate the very notion of and the basis for the allowance of depreciation claimed by an assessee in respect of the assets used by him in his business. This also accords with the scheme of the Act in providing for the allowance of depreciation, Under the provisions of the Act, income is subject to tax without any reference to the exhaustion, or diminution or even the destruction of the value of capital which includes building, machinery, etc. If the income is so subjected to tax without reference to the exhaustion or erosion of the value of the capital, it would no doubt work great hardship to assessees engaged in business using the building, machinery, plant or furniture, etc. It is only with a view to provide relief to the assessees in such cases, that the grant of allowance in respect of depreciation had been thought of and provision therefore had also been made in Section 32 of the Act. It is difficult to envisage the availability of the benefit of such an allowance to a person who has merely made an advance for the purpose of acquiring a capital asset as a building, machinery, plant, etc., but had not actually acquired legal title to it. In other words, in cases where the assessee had not secured legal title to the buildings, plant or machinery, it is difficult to extend the benefit of the granting of the allowance of depreciation to those assessees, as that would amount to recognition of mere possession of the assets without anything more, as the fulfilment of one of the requirements u/s 32 of the Act to be eligible for the grant of an allowance by way of depreciation. "

34. We may add a few words more as regards the Allahabad decision in Additional Commissioner of Income Tax Vs. U.P. State Agro Industrial Corporation Ltd., .

35. The Allahabad High Court felt that the decision of the Supreme Court in R.B. Jodha Mal Kuthiala Vs. The Commissioner of Income Tax, Punjab, Jammu and Kashmir, Himachal Pradesh and Patiala, which according to it, had been omitted to be noticed by the Delhi High Court in Commissioner of Income Tax Vs. Hindustan Cold Storage and Refrigeration P. Ltd., , made all the difference. After anxiously considering the decision of the Supreme Court, we are clearly of the view that the Supreme Court decision does not contain any principle or logic which would induce us to take a different view of the construction of Section 32. The Supreme Court case essentially dealt with the effect and impact of the Pakistan Evacuee Property Vesting Act. The assessee in that case had owned assets in Lahore in the form of a hotel. And for the purpose of establishing the hotel, the assessee had taken huge loans from banks. Interest payable on the loans so taken was claimed as deduction. It was in this context that the question arose about the assessability of income from the hotel property in Pakistan. The Supreme Court found that in the light of the provisions of the Pakistan Ordinance, the assessee did not have any ownership over the hotel. The observations of the Supreme Court made in that decision have to be understood in that context. The Supreme Court was concerned with a case about the taxability of income from property. The income-generating activity and the interconnection between the assessee and the asset involved in the activity had to be adjudged in that context. This emphasis is seen from the observations contained at page 575 :

" It must be remembered that Section 9 brings to tax the income from property and not the interest of a person in the property. A property cannot be owned by two persons, each one having independent and exclusive right over it. Hence, for the purpose of Section 9, the owner must be that person who can exercise the rights of the owner, not on behalf of the owner but in his own right. " (emphasis* supplied)

36. The summing up of the Supreme Court in relation to the statutory scheme of the Ordinance was (at page 574):

"The evacuee could not exercise any rights in that property except with the consent of the Custodian. He merely had some beneficial interest in that property. No doubt that residual interest in a sense is ownership. The property having vested in the Custodian, who had all the powers of the owner, he was the legal owner of the property. In the eye of the law, the Custodian was the owner of that property. " (Emphasis* supplied)

37. Section 34 of the Income Tax Act as also its predecessor Section 10(2)(vi) of the Indian Income Tax Act, 1922, had a close model in the English enactments.

The Customs and Inland Revenue Act, 1878, is the legislative ancestor (as pithily put by Robert Goff L.J. in Stokes v. Cos-tain Property Investments Ltd. [1984] 1 All ER 849(CA)). Section 12 of that enactment allowed as a deduction " the diminished value by reason of wear and tear during the year of any machinery or plant used for the purpose of the concern, and belonging to the person or company by whom the concern is carried on ". The words " diminished value by reason of wear and tear " became abridged in later time as " depreciation ". No doubt, the section employed not the word "ownership" but the words "belonging to". Macnaghten J. regarded "belonging" as meaning ownership in that context. (See Union Cold Storage Co. Ltd. v. Simpson [1938] 4 All ER 673). The implication of the term " belonging" had been examined by the English courts on earlier occasions also. Additional incentives had been offered to the industry by the later enactments. Some of those important enactments up to 1971 have been catalogued in Stoke''s case [1984] 1 All ER 849, the Customs and Inland Revenue Act, 1878, Income Tax Act, 1918, Income Tax Act, 1945, Income Tax Act, 1952, Finance Act, 1957, Capital Allowances Act, 1968, and Finance Act, 1971. The purpose of these statutory provisions was undoubtedly to encourage investment (Robert Goff L.J. says so in hi3 speech). Lord Justice Fox observed (at p. 855):

" The purpose of the statutory provisions is evidently to encourage investment in machinery and plant."

38. Sections 41 and 44 of the Finance Act, 1971, dealt with allowances, the first year allowance and written down allowance subject to the condition that the machinery or plant belonged to the assessee. The Court of Appeal had occasion to consider the scope and amplitude of the term " belonging to " in that context. Commenting on the expression " belonging to" in the 1878 Act, Fox L.J. observed (at p. 854):

" The requirement of '' belonging '' first appears in the legislation on this subject in Section 12 of the 1878 Act. In that section, it is difficult to suppose that the word '' belonging '' can have been intended to mean anything other than absolute ownership."

and later (at p. 854):

" I agree that '' belong '' and '' belonging '' are not terms of art. They are ordinary English words. It seems to me that, in ordinary usage, they would not be satisfied by limited interests. For example, I do not think one would say that a chattel '' belongs to X '' if he merely had the right to use it for five years. Nor do I think it is an apt use of language to say that landlord''s fixtures '' belong '' to the leaseholder. "

39. The ultimate conclusion was that the lessee who had beneficial interest arising under the lease for even such a long period as 99 years, could not claim to be the person to whom the machinery and plant belonged.

40. It is comforting to note that the aforesaid decision of the Court of Appeal considerably contributes strength and support to our conclusion as reached above. We might further note, as did the Court of Appeal in the above decision, that mighty minds like those of Macnaghten J. and du Parcq L.J. had similar trends of thought. (See [1938] 4 All ER 673 and [1939] 2 All ER 94 (CA)).

41. In the light of our discussion, we have no hesitation to negative, on the facts and circumstances disclosed, the claim of the assessee for depreciation. We answer the cases in the manner indicated above.