
(1968) 11 DEL CK 0003

In the Delhi High Court

Case No : Income-tax Reference No. 63 of 1965

S. Kartar Singh

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 01-11-1968

Acts Referred:

Citation : (1969) 73 ITR 438

Hon'ble Judges : T.V.R. Tatachari, J;S.K. Kapur, J

Bench : Division Bench

Advocate : N.D. Karkhanis and Bishamber Lal, for the Appellant; A.N. Kirpal and D.K. Kapur, for the Respondent

Judgement

Kapur, J.—The assessed's three appeals Nos. 1504, 1505 and 1506 of 1963-64 relating to the assessment years 1959-60, 1960-61 and 1961-62 were disposed of by the Income Tax Appellate Tribunal by a single order dated February 17, 1964. At the instance of the assessed, the Tribunal referred the following question of law to this court;

"Whether, on the facts and in the circumstances of the case, the assessed was liable to pay tax under the head "income from property" u/s 9 of the Indian Income Tax Act, 1922, in respect of the bona fide annual value of the property known as No. 1/21, Asaf Ali Road, New Delhi ?" 2. The assessed, a non-resident, had income, inter alia, from house property. He executed a settlement deed with respect to his property at 1/21 Asaf Ali Road, New Delhi, in favor of his father, Atma Ram. The said deed is a registered document. The preamble of the said document, inter alia, recites:

" and whereas the grantor in consideration of his natural love and affection and filial duty for the grantee is desirous of making provision for the maintenance of his father who owing to old age naturally depends upon the grantor, for the life-time of the grantee ..." 3. Clauses 1, 2, 3 and 4 of the deed also deserve reproduction and read :

" 1. The grantor for the purposes of maintaining the grantee according to the parties" social status, transfers in favor of the grantee for the lifetime of the said grantee the right to the usufruct and income of the said hereditaments and for that purpose transfers in his favor and authorises him to exercise all the powers and rights of an owner that the grantor himself possesses and enjoys ;

2. By way of clarification it is further stipulated that the grantee will be entitled to receive all the rents and income from the existing leases or any future leases, to enter into contracts of leases, to evict tenants and to induct tenants into the said hereditaments and in short he shall possess during his life-time all the powers and rights of the owner of property except that he cannot sell, mortgage or gift away the corpus of property which is to remain intact and unencumbered and will after the demise of the grantee revert to the grantor or his heirs and successors as the case may be;

3. The grantee shall pay all taxes of the nature of house-tax, Income Tax, wealth-tax and other government or municipal levies, charges and duties arising out of the rights to and concerning the income and profits of the said property as also the lease money payable to the Delhi Improvement Trust;

4. As a natural corollary to the above, the grantor or his heirs and successors shall not during the lifetime of the grantee have any right to claim any part of the income of the said property nor will the grantor or his successor and assigns be in any way entitled to encumber or create any right or interest in any person in derogation of the rights of the grantee."

4. On the same day, that is, February 10, 1958, the assessed's father, Atma Ram, executed a deed of settlement. The assessed and his five sons were the beneficiaries under the said instrument. The settlement was stated to have been made in consideration of natural love and affection and out of a desire for making provision for the maintenance, education, hospital treatment and other benefits of the settlor's grand-children. The deed, inter alia, provides for payment of expenses on account of education, maintenance, medical and hospital treatment of the settlor's grand-children till they attain 21 years of age or " being female shall be under that age and be unmarried . . . " and for payment of an annuity of Rs. 15,000 during the period of 15 years from the date of the execution. The assessed contended before the Income Tax authorities that, since the income from the property in question had been irrevocably settled by him on his father during the latter's lifetime and he was not deriving any direct or indirect benefit from the said income, he was exempt from payment of tax thereon by virtue of the third proviso to Section 16(1)(c) of the Indian Income Tax Act, 1922. The Income Tax Officer disallowed the assessed's claim holding that:

" (a) the transfer was only of the income and the assessed -continued to be the legal owner of the property ;

(b) it was not a case of diversion of income by an overriding title but only that of

application of income after it has accrued to the assessed; and

(c) the income in the hands of the assessed was, in the circumstances, assessable u/s 9 of the Act."

5. The Income Tax Officer also decided that, in any event, the assessed derived indirect benefit out of the income from the property in dispute in the form of receipts under his father's trust deed of the same date and, Therefore, the case was not covered by the third proviso to Section 16(1)(c). In appeals before the Appellate Assistant Commissioner the assessed disputed the finding of the Income Tax Officer that he continued to be the owner of the property notwithstanding the execution of the settlement deed and again raised the same contentions as raised before the Income Tax Officer but the Appellate Assistant Commissioner affirmed the findings of the Income Tax Officer. The assessed preferred appeals before the Income Tax Appellate Tribunal and again reiterated the same pleas. The Tribunal disposed of the three appeals by a consolidated order as mentioned hereinbefore. It decided that :

"(a) u/s 9 it was the ownership of property and not the actual income from the house property, measured in terms of its annual letting value, that was the subject-matter of taxation ;

(b) in view of the above, the heart of the problem was whether the assessed continued to be the owner of the property within Section 9 of the Act notwithstanding the execution of the settlement deed ;

(c) the reading of the instrument of settlement showed that the assessed had not divested himself of the ownership of the property in dispute and he was, Therefore, liable to be assessed in respect thereof u/s 9 of the said Act;

(d) the third proviso to Section 16(1)(c) of the said Act applied only to those cases where income from the assets was taxable but did not " regulate income or annual value provided in Section 9 ; and

(c) Section 16(1)(c) dealt only with actual and real income arising to a person and " leaves out of its scope income from property u/s 9 ". In other words, Section 16(1)(c) did not at all cover the cases of deemed income such as income from property u/s 9. "

6. Mr. Karkhanis, the learned counsel for the assessed, argued that the assessed ceased to be the owner of the property by reason of the settlement deed dated 10th February, 1958, and, Therefore, the income was not taxable in his hands u/s 9 and, secondly, that the settlement deed being irrevocable during the lifetime of the beneficiaries as contemplated by the third proviso to Section 16(1)(c), the income could not be taxed in the hands of the settler because the said third proviso excluded the operation of Section 16(1)(c) if (a) the settlement was not revocable during the lifetime of the beneficiaries and (b) the settler derived no direct or indirect benefit from the settlement. Mr. Karkhanis maintained that the settlement of property by Atma Ram, the assessed's father, was a separate and

independent transaction and it could not be said that by reason of that settlement the assessed derived indirect benefit. Mr. Kirpal, the learned counsel for the revenue, on the other hand, said that:

(1) notwithstanding the settlement made by the assessed, he continued to be the owner of the property ;

(2) Section 16(1)(c) made only such income of the settlor taxable in the hands of the settler as, but for Section 16(1)(c) and the third proviso thereto, would not be otherwise taxable in the settlor's hands and it did not prevent income from being taxed in the hands of the settler who, under the general law, would be taxable in respect of such income.

7. In short, Mr. Kirpal's argument on this aspect was that if " A " applied his income after it had accrued to him, the said income would be taxable in A's hands as tax is attracted the moment income accrues; that such application of income will not be exempt by virtue of the third proviso to Section 16(1)(c) and that the said Section 16(1)(c) read with the third proviso would come into play only where diversion of income was made by an overriding title at the source before it became the income of the transferor; and (3) since tax on property had to be paid by the owner of the property irrespective of the nature of diversion by him of the income, i.e., either at source or by applying the same after accrual, no overriding title could be created with respect to the property taxable u/s 9 and, consequently, Section 16(1)(c) could have no application to such property.

8. As to whether or not the assessed continued to be the owner of the property notwithstanding the settlement made by him, I am in agreement with the view taken by the Tribunal. Mr. Karkhanis relied on a Full Bench decision of this court in COMMISSIONER OF Income Tax, PUNJAB, JAMMU AND KASHMIR, AND HIMACHAL PRADESH Vs. R.B. JODHAMAL KUTHIALA., . In that case, the question before the Full Bench was whether or not the persons displaced from the area now comprised in Pakistan continued to be the owners of the properties left by them in Pakistan within Section 9 of the Indian Income Tax Act, 1922, notwithstanding the evacuee legislation in force in Pakistan. While holding that such persons did not continue to be the owners of such properties, I said :

" The term " owner " may have a variety of meanings depending on the context in which it is used. Broadly, an " owner " is one who has dominion over property which is the subject of ownership. It is well accepted that the term "owner" has no rigid meaning and its meaning may not be the same under all the circumstances. It is not a technical term, but rather one of wide application in various connections. It is a comprehensive and generic term and must be construed in the setting in which it is used. It may be used to convey a meaning, sometimes broad and sometimes quite restricted. In some statutes it may mean a person in whom the property is for the time being beneficially vested and who has the occupation or control or usufruct of it. It may also be used to describe a person not having a full title but only a bare legal title. Again, in a given context,

the term "owner" may signify any person having any estate or interest in the land no matter how slight. . . Section 6 of the Act describes six heads of income and the third head is "income from property". The said provision shows that Section 9 merely prescribes the notional method of arriving at the income from property on which an assessed has to be taxed but basically the tax is on income. It follows that the property must be such from which an owner can earn income, or, in other words, the assessed must be in a position to earn income from the property unless he chooses not to do so or the circumstances do not permit him to earn income even though he has dominion or control over the property. " 9. Relying on this decision, Mr. Karkhanis initiated a contention that the settlement deed deprived the assessed of all dominion and control over the property and rendered him incapable of earning any income there from. That, according to Mr. Karkhanis, negated the contention of the revenue that the assessed was its owner.

10. The assessed was, before the execution of the settlement document, the owner of the said property and the question to be seen is whether he transferred that ownership or merely the income. If the conclusion be that he transferred only the income, the residue, namely, the ownership, will still continue to vest in the assessed. I may also add that in that situation even the test laid down by the Full Bench would be satisfied, as it would be a case of a person capable of earning income but choosing not to do so. It is also to be borne in mind that the question before the Full Bench was different, namely, the impact of the evacuee legislation in Pakistan on the ownership of the assessed.

11. I will now proceed to examine the terms of the settlement deed. One of the clauses in the preamble indicates the object of the settlement, namely, the desire of making a provision for the maintenance of the assessed's father who owing to old age depended on the assessed for the lifetime of the father. The preamble proceeds to say, "... and whereas the grantor for the purpose of such maintenance is desirous of making a settlement in favor of the grantee ..." The words " for the purpose of " are quite significant. Clause 1 of the settlement deed also starts with the words, " the grantor for the purposes of maintaining the grantee . . . ", and provides for the transfer in favor of the grantee the right to the usufruct and income of the property. The subject-matter of transfer, Therefore, is the right to the usufruct and income. The latter part of the clause reads :

"... and for that purpose transfers in his favor and authorises him to exercise all the powers and rights of an owner that the grantor himself possesses and enjoys." 12. Here again, the words "for that purpose" and the words " authorises him to exercise all the powers and rights of an owner " are destructive of the assessed's contention as to his having been divested of the ownership. Clause 2 confers powers to evict and induct tenants, etc., and provides that the grantee shall "possess during his lifetime all the powers and rights of the owner of property except that he cannot sell, mortgage or gift away the corpus which is

to remain intact and unencumbered. ..." That again shows that if the ownership had been transferred it was unnecessary to, say " all the powers and rights of the owner of property ", which indicate" that in fact the grantee was not made the owner but the property was transferred to enable him to enjoy the income there from. Clause 4 of the settlement instrument is most telling. It provides that the heirs and successors of the grantor shall have no right, during the lifetime of the grantee, to claim any part of the income of the property nor will the grantor or his successors and assigns be, in any way, entitled to encumber or create any right or interest in any person in derogation of the rights of the grantee. The use of the word " assigns " shows that the power to transfer the property still inheres in the grantor but it cannot be exercised in derogation of the rights of the grantee. It must consequently be held that the assessed continued to be the owner of the property.

13. It is now appropriate to analyze the scope of Section 16(1)(c) and the third proviso. In my opinion, the third proviso does not ensure to the benefit of an assessed owner in case such owner merely applies his income as against diverting it at source. In other words, the proviso does not exclude from the assessed's total income such sums as are paid by him, which are, apart from Section 16, a part of his income and amount merely to an application of his income. It follows that, if an assessed applies his income and does not divert it at source before becoming his income, it would continue to be taxable in the hands of the transferor and will not be excluded from his total income by operation of the third proviso. In *A. R. Rangachari Vs. Commissioner of Income Tax, Madras*, , the Madras High Court held that if a certain sum is taxable in the hands of an assessed, though applied in a particular manner under a binding obligation, no question can arise of applying the provisions of Section 10 which section only deems income to be his when apart from this provision it is not his income. It was observed:

" It is only in cases where there is no transfer of an asset but merely a disposition of income that the position becomes a little ambiguous. The question is whether the distinction which formerly obtained between an application of income and its diversion, as we have endeavored to state a little earlier, continues still to be crucial. On the one hand, the contention urged on behalf of the assessed is that such a distinction is out of place in the scheme of the provisions embodied in Section 16(1)(c) and its provisos and if a settlement or disposition of income, whether it be an application or a diversion of income, satisfied the requirements of the third proviso, the income disposed of ceases effectively to be that of the transferor thus conferring an advantage on transferors which they did not previously enjoy. The contention urged, on the other hand, on behalf of the tax authorities is that the law in regard to cases of an application of income continues to be the same even after the amendment of 1939, whereas there is a change in favor of the revenue in cases where there is a diversion of income under an overriding title. Formerly, the period during which the diversion operated was immaterial as also whether any benefit accrued to the

disponer by the settlement. Now, under main Clause (c), every disposition of income is disregarded in computing the total income of the disponer but by reason of the third proviso dispositions of a particular character and ensuring for a particular duration are saved. In other words, settlements and dispositions which are merely applications of income are not within Section 16(1)(c) or the provisos, while dispositions which are diversion of income are saved only when the conditions of the third proviso are satisfied. " 14. This decision of the Madras High Court was taken in appeal to the Supreme Court (K.A. Ramachar and Another Vs. Commissioner of Income Tax, Madras,), and their Lordships observed :

"It is not necessary to refer in detail to the decisions of the Appellate Assistant Commissioner, the Tribunal and the High Court. The High Court in an elaborate judgment pointed out that Section 16(1)(c) did not apply to these proceedings and that the third proviso was, Therefore, not attracted. It also held that the income had accrued to the assessed, in the first instance, and had then been applied for payments under the deeds. " 15. From the above observation it is clear that their Lordships of the Supreme Court approved the view taken by the Madras High Court as to the interpretation of Section 16(1)(c). In Provat Kumar Mitter Vs. Commissioner of Income Tax, West Bengal, , the assessed by a deed of settlement assigned to his wife the right, title and interest to all dividends which might be declared or which may be due and payable in respect of those shares for the term of the wife's life. Their Lordships of the Supreme Court held that it was a case of application of income after it had accrued and was taxable in the hands of the assessed. It was observed :

" If this is the true construction of the document, then it is clear to us that the answer given by the High Court to the question referred to it is correct. The High Court rightly pointed out that the company paying the dividend can pay it only to the registered shareholder or under his orders (see Howrah Trading Co. Ltd. Vs. Commissioner of Income Tax, Central, Calcutta.,); Therefore, Section 16(1)(c) of the Income Tax Act was not attracted nor the third proviso thereto and the income continued to accrue to the assessed, but was thereafter paid over to his wife under the terms of the contract. The income was, Therefore, assessable in the hands of the assessed, because it was part of his income though applied subsequently towards payment to the wife under the terms of the contract. " 16. The position that emerges from the reading of Section 16(1)(c), the third proviso thereto and the various decisions referred, to hereinbefore is this : Section 16(1)(c) contemplates income arising to the transferee and then its being taxed in the hands of the transferor. If under the general law an income accrues to the transferor and does not become that of the transferee by reason of the transfer, Section 16(1)(c) does not apply and the income continues to be taxable in the hands of the transferor. In that view, Section 16(1)(c) would be indifferent to the mere application of income. The third proviso comes into play when the settlement is either not revocable for a period exceeding six years or during the lifetime of the settle and the settler derives no direct or indirect benefit there

from. If both the conditions in the third proviso are satisfied the transferee of income, which transfer must be by an overriding title, will be taxed with respect to the income and not the transferor. If, on the other hand, any one of the two conditions in the third proviso is not satisfied the transfer of income by an overriding title will be of no avail to the settler and the income will continue to be taxed in his hands. Mr. Kirpal endeavored to show that the third proviso was applicable only to the latter part of section "16(1)(c), namely, where there was a transfer of assets and not to a case where income alone had been settled. He contended that in the first part of Section 16(1)(c) which dealt with the transfer of income only the words used were " by virtue of a settlement or disposition whether revocable or not" while the proviso dealt only with revocable settlements which are dealt with in the latter part of Section 16(1)(c). The argument sounds attractive at first sight but lacks validity. True, the first part of Section 116(1)(c) deals with both settlements, revocable or not, but the proviso carves out an exception that if a settlement is not revocable for the specified period and the settler derives no direct or indirect benefit there from then even in case of transfer of income only Section 16(1)(c) will not apply. The legislature has chosen to say in the third proviso that the "clause", that is, Clause (c) of Sub-section (1) of Section 16, shall not apply where given conditions are satisfied and I do not think that the legislature could have been guilty of such a confusion as to have intended to extend the operation of the proviso only to part of Section 16(1)(c) and yet used the expression " this clause ", This very question fell for consideration before the Bombay High Court in D.R. SHAHAPURE Vs. COMMISSIONER OF Income Tax, BOMBAY, . Kania J. (as his Lordship then was) dealing with this very argument observed:

" The proviso opens with the words " provided further that this clause shall not apply . . . " There is no warrant for reading the word " clause " as applicable only to the second half of Clause (c), and not the first half also. In my opinion, the last words of the proviso, quoted above, also do not help the Commissioner, because the power to revoke may be equally applicable to the income, which is payable, as to the assets which are transferred. In proviso (1) the transfer of income and assets are treated, so far as this section is Concerned, on the same footing. It appears Therefore that the third proviso, as worded, can equally well apply to the first part of Section 16(1)(c). It was next argued that having regard to the words "revocable or not" used in the first part of Clause (c), the third proviso cannot apply until there was a revocable transfer of assets. No authority is cited to support this construction, which is against the very words of the clause. The words " revocable or not, in my opinion, are used in contradistinction to " revocable transfer ", used in the second part of that clause. Although the settlement may be revocable, the power may not be capable of being exercised for a period exceeding six years, or for the lifetime of the person for whose benefit the income is settled. The deed may not be revocable and yet the settler may derive a benefit directly or indirectly from the income. The use of the words " revocable or not" in the first part of Section 16(1)(c) does not, Therefore,

necessarily exclude the operation of the third proviso." 17. I am in respectful agreement with this view.

18. This takes me to the next argument of Mr. Kirpal, namely, that if Section 16(1)(c) applies only where income is transferred by an overriding title so that it ceases to be the income of the transferor under the general law the said section cannot apply at all to income from property covered by Section 9, as in the case of such a property there cannot be a diversion by overriding title, in view of the fact that the owner must pay tax on the annual letting value of the property in disregard of the diversion of the income even by an overriding title. In short, the argument is that Section 16(1)(c) applies only when there is a diversion of income by an overriding title and, since there cannot be any such diversion in the case of a property covered by Section 9, the assessed must pay tax u/s 9, he being the owner of the property, I have no hesitation in accepting the contention of Mr. Kirpal. u/s 6, various heads of taxable income are set out and the third head is " income from property ". That head is again dealt with in Section 9. The tax under this section is upon the owner, legal or beneficial. It is levied not upon the actual income but on notional income represented by bona fide annual letting value. In the result even where the owner had diverted his income at source he will continue to be liable to pay tax on the annual letting value subject to specified deductions given in Section 9 itself. One of the allowances provided in Section 9(1)(iv) is annual charge not being a capital charge. The allowance with respect to the annual charge marks a departure from the principle that where income is applied by an assessed the assessed must continue to pay tax thereon. If there is an annual charge created even voluntarily the assessed would be entitled to deduction provided it is a legally enforceable charge. The purpose of the charge would be indifferent. That lends a further support to the view that I am taking, namely that owner has to pay tax on property covered by Section 9, even when he has diverted his income at source. He will, however, be entitled to deduct the annual charge. Such an annual charge may comprise a charge created on the property for the payment of annual sum to the assessed's mother out of natural love and affection (PRINCE KHANDERAO GAEKWAR OF BARODA Vs. COMMISSIONER OF Income Tax, BOMBAY CITY., or charge created to secure payment of alimony to the assessed's wife (COMMISSIONER OF Income Tax, WEST BENGAL Vs. STATE BANK OF INDIA., . The other view would result in an anomalous position and defeat the very purpose of Section 9. Take a case where the property is self-occupied and yields no income. If the owner has diverted his income from such property by an overriding title the transferee will not have to pay tax as there is no income from the property and the transferor will escape liability by reason of creation of an overriding title with respect to income. The nature of deduction on account of annual charge shows that the legislature intended to allow such charge whether by way of application of income or diversion by an overriding title to be deducted out of the owner's notional income and tax the balance of the letting value in the hands of the owner. This view derives support from the decision of the Judicial Committee in (1941) 9 ITR

695 (Privy Council) . In that case it was held that, since an impartible estate is owned by the joint family, though its income belongs to the estate-holder for the time being, the assessment u/s 9 should be made on the Hindu undivided family as the owner and not on the holder who receives the income. It was observed :

" The learned judges of the High Court have rejected the claim of the Commissioner to tax the assessed as an individual upon the income of the house property u/s 9 of the Act. The ground of their decision is that" the owner " of the buildings and lands appurtenant thereto is not the assessed but the Hindu undivided family. With this reasoning their Lordships agree. They think that the learned judges were right in refusing to follow the Bombay case wherein it was held that the words " property of which he is the owner " are to be read as meaning " of which annual value he is the owner": COMMISSIONER OF Income Tax, BOMBAY Vs. ABUBAKER ABDUL REHMAN AND OTHERS (MUTAVALEES OF WAKF)., . However difficult it may be in some cases to apply the simple and ordinary phrase " owner of property" to the facts, it is not permissible to substitute a phrase which is of dubious and noticeably different meaning." 19. No doubt, this decision was superseded by the legislature with respect to impartible estates by Section 9(4) (a) in 1948 but the observations quoted above bring out clearly the scope of Section 9(1). The discussion yields the following result:

(1) Section 16(1)(c), which was introduced to overtake the expedient taken recourse to by the assesseds in diverting their income, applies only where transfer of income is by an overriding title so as to make the income the income of the transferee;

(2) Since the owner of the property continues to be taxable by reason of his ownership subject to the prescribed deductions, the creation of an overriding title with respect to income from house property will not relieve the owner from liability to pay tax u/s 9 ;

(3) Since the assessed continued to be the owner, he was rightly taxed u/s 9.

20. My answer to the question, Therefore, is in the affirmative and in favor of the revenue.

21. The assessed will pay the costs which are fixed at Rs. 250.

Tatachari, J.

22. I agree.