

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 21.12.2020

CORAM

THE HON'BLE DR.JUSTICE VINEET KOTHARI
AND
THE HON'BLE MR.JUSTICE M.S.RAMESH

Tax Case No.2624 of 2006

1. Thiru.M.O.H.Farook (Deceased)
2. Mallika
3. Shajahan
4. Jasmin

(Appellants 2 to 4 are brought on record as L.Rs. of the deceased sole Appellant vide order dated 30.11.2012 made in M.P.Nos.2 & 3 of 2012) ...Appellants/Respondents

Vs.

The Assistant Commissioner of
Income Tax,
Circle I, Kumbakonam. ...Respondent/Appellant

Tax Case filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, 'B' Bench, Chennai, dated 25.11.2005 made in ITA No/683(Mds)/2001, preferred against the order of the Commissioner of Income Tax (Appeals)-XIII, Chennai in ITA No.29/2000-2001 dated 22/02/2001 filed against the Assessment order of the Assistant Commissioner of Income Tax Circle-I, Kumbakonam, dated 09/03/2000 for the Assessment Year 1995-96.

For Appellant : Mr.R.Parthasarathy

For Respondent : Mr.M.Swaminathan,
Senior Standing Counsel assisted by
Ms.V.Pushpa, Jr.Standing Counsel

JUDGMENT

(Delivered by DR.VINEET KOTHARI,J)

Heard Mr.R.Parthasarathy, learned counsel appearing for the Appellants/Assessee and Mr.M.Swaminathan, learned Senior Standing Counsel appearing for the Respondent/Revenue.

2. The Tax Case has been admitted on 23.6.2008 on the following questions of law:-

"i) Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in not appreciating that no part of the consideration for sale was received by the appellant and same was directly paid to the Bank by the purchaser in discharge of the mortgage amount and therefore no capital gains arises in the hands of the appellant?

ii) Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in not holding that there was a diversion of the sale proceeds towards redeeming the interest of the mortgagor and therefore the amount so diverted was not liable to capital gains tax?"

3. The relevant portion of the order passed by the learned Tribunal is extracted below for ready reference:-

"3. The brief facts are that the late assessee alongwith Smt.D.Zeenath and Zubaida Ammal purchased a landed property by documents dated 11-7-1980 and 4-2-1991. The assessee sold the same in September, 1994. The total capital gain arrived at was Rs.1,63,54.490/- and the assessee's one third share came to Rs.54,51,000/-. In the return filed originally after notice under section 148 the assessee declared income from house property alone. Regarding capital gain the contention of the assessee was that the entire sale consideration was directly paid towards loan amount of M/s.M.O.Hassan Kuthoos Marickar (P) Ltd. with State Bank of India, Pondicherry. This had happened because the company was unable to repay the loan and the co-owners including the assessee was asked by the bank to repay the loan payable by the company and for that purpose the assessee sold the land and the sale proceeds were directly paid to M/s.M.O.H.(P) Ltd. The contention of the assessee was that the amount was paid directly to the loan account of the company with the bank. The assessee had not received any consideration and therefore there was no capital gain arising out of the above sale. However, the Assessing Officer rejected the contention of the assessee and he computed the capital gain as per

sections 48 and 49 of the Income-tax Act, 1961, wherein the one third share in the capital gain attributable to the assessee came to Rs.61,72,231/-. While computing the capital gain the Assessing Officer deducted the cost of acquisition of the land and the cost of improvement which was in the nature of cost of compound wall and sand filling on site. Aggrieved, the assessee appealed to the Commissioner (Appeals) who found that the decision of the Hon'ble Kerala High Court in the case of CIT vs. Smt.Thressiamma Abraham, 227 ITR 802 will support the case of the assessee on the ground that the assessee has not received the payment as a result of transfer, which was paid directly to the bank by the purchasers of the above property. He, therefore allowed the claim of the assessee on this issue of capital gains. The Revenue is now aggrieved and in appeal before us.

4. We have perused the grounds of appeal and the records available before us. We have also heard the learned counsel for the assessee and considered his submissions. It is not disputed that the assessee never incurred the expenditure wholly and exclusively in connection with such transfer. No doubt it has wider connotation than the expression for the transfer. In the decision of the Hon'ble jurisdictional High Court in the case of CIT vs. N.Vajrapani Naidu, 241 HR 560 a mortgage had been created by the vendor-assessee and the amount paid to the other creditors by the vendee was for the discharge of the debts which had been incurred by the assessee. The amount was paid as part of consideration to the sale. Hence the assessee's claim was held to be rightly rejected by the Income-tax Officer. Section 48 of the Income-tax Act clearly lays down the condition that to compute capital gain the expenditure must be incurred wholly and exclusively in connection with such transfer and cost of acquisition of the asset and the cost of improvement thereto. These are the expenses available for deduction while computing capital gains. Here in this case the sale consideration was paid directly to the company M/s.M.O.H.(P) Ltd. towards the loan from the bank. It is hit by section 48 of the Act as it is not an allowable deduction under

section 48. Therefore the claim of the assessee that there is no capital gain since the assessee has not received any consideration, is to be brushed aside. The decision of the Hon'ble Supreme Court in the case of RM.Arunachalam vs. CIT, 227 ITR 222 is directly on the point at issue. However, the learned counsel for the assessee attempted to impress us that according to the aforesaid decision of the Hon'ble Supreme Court at page 225 of the decision the payment for the purpose of acquiring the interest of the mortgagee in the property by the heir was held to be regarded as cost of acquisition under section 48 read with section 55(2) of the Act. But in this case there is no liability attached to the succession. The assessee purchased the property without any encumbrance and the subsequent encumbrance created as a guarantee to the company M/s.M.O.H.(P) Ltd., has nothing to do and it cannot be deducted as it never comes within the allowable deduction under section 48 of the Act. Respectfully following the decisions of the Hon'ble Supreme Court and the jurisdictional High Court we set aside the order of the Commissioner (Appeals) and confirm the order of the Assessing Officer."

4. Both the learned counsels submitted that the controversy involved in the present Tax Case is covered by the Judgement rendered by a Division Bench of this Court in Tmt.D.Zeenath v. Income-tax Officer, Ward-I(1) Nagapattinam, in which one of us (Dr.Justice Vineet Kothari) was a party, wherein the Court has held as under:-

"29. In our opinion, the ratio in R.M.Arunachalam (supra), squarely applies to this case. As held by the Hon'ble Supreme Court, such payment would go to reduce the cost of acquisition only where the mortgage had not been created by the assessee, but was created by the person from whom the assessee had acquired the title and the mortgage was subsisting at the time title was acquired by the assessee. The position is, however, different where the mortgage is created by the owner after he has acquired the property. The clearing off of the mortgage debt by him prior to transfer of the property would not entitle him to claim deduction under section 48 of the Act because in such a case he did not acquire any interest in the property subsequent to his acquiring the same.

30. This position had been reiterated by the Hon'ble Supreme Court in, V.S.M.R. Jagadishchandran (supra). The facts in that case were as follows. The facts and the judgment of the Hon'ble Supreme Court are extracted below:

'This appeal by the assessee is directed against the order dt. 25th July, 1984 passed by the Madras High Court in TC No. 145 of 1983 wherein the High Court on an application filed under s. 256(2) of the Act declined to direct the Tribunal to state a case and refer the following questions of law to the High Court :

- "1. Whether the Tribunal was right in holding that the levy of the capital gains of Rs. 68,400 is proper under the facts and circumstances of the case ?
2. Whether the Tribunal was right in holding that mortgage debts does not constitute diversion at source?
3. Whether the debts discharged by the applicant on the properties cannot be said to enhance the cost of acquisition."

The assessee sold a house property No. 22, Chairman Muthurama Iyer Road, Madurai for a sum of Rs.90,000 subject to incumbrance in the assessment year 1975-76 and for the same assessment year he sold plot Nos.1, 3 and half of plot No.4 in T.S. No.831/1 for a sum of Rs.12,600. The Income-Tax Officer computed the capital gains in respect of the said properties at Rs.68,400. The assessee questioned the computation of capital gains before the Appellate Assistant Commissioner and contended that the debts in respect of which mortgage had been executed were discharged by the buyer himself out of the sale proceeds, that the debts should be considered as increase in cost of acquisition of the properties and that in any event the debts may be treated as improvement to the property or as the cost of obtaining clear title to the property. The Appellate Assistant Commissioner rejected the said contention. He, however, upheld the contention of the assessee that

there was an overriding title of the creditors in respect of the sale proceeds and, therefore, there was diversion at source on the basis of such overriding title and the assessee was not liable to charge under the capital gains in respect of the sale of the properties and, therefore, he deleted the capitals gains of Rs.68,400 as computed by the ITO. The Tribunal, following the decision of the Kerala High Court in *Ambat Echukutty Menon v. CIT* (1(1978) 111 ITR 880 (Ker), and the decision of the Madras High Court in *CIT v. V.Indira* (1979) 119 ITR 837 (Mad) held that clearing of the mortgage debt could neither be treated as "cost of acquisition" nor as an "cost of improvement" made by the assessee. The Tribunal, therefore, held that the deduction of the capital gains was not justified. Since the Tribunal declined to refer to the High Court the questions referred to above, the assessee filed an application under s.256(2) of the Act before the High Court which has been rejected by the impugned order. The High Court has relied upon the decision of the Full Bench of the High Court in *S. Valliammai & Anr. v. CIT* (1981) 127 ITR 713 (Mad) and has held that by discharging the mortgage debt subsisting on the property which was the subject-matter of a sale, the assessee was not either improving or perfecting his title or improving the property in any manner and, therefore, the amount paid for discharging the mortgage debt cannot be taken to be for the cost of acquisition as contended by the assessee.

In Civil Appeals Nos.6098-6101 of 1983 [since reported as *R. M. Arunachalam etc. v. CIT* (1997) 141 CTR (SC) 348 filed against the judgment of the Full Bench of the Madras High Court in *S. Valliammai & Anr. v. CIT* (supra) we have examined the correctness of the view of the Kerala High Court in *Ambat Echukutty Menon v. CIT* (supra) and have held that the said decision does not lay down the correct law in so far as it holds that where the previous owner had mortgaged the property during his life time the clearing

off the mortgage debt by his successor can neither be treated as cost of acquisition nor as cost of improvement made by the assessee. It has been held that where a mortgage was created by the previous owner during his time and the same was subsisting on the date of his death, the successor obtains only the mortgagors interest in the property and by discharging the mortgage debt he acquires the mortgagees interest in the property and, therefore, the amount paid to clear off the mortgage is the cost of acquisition of the mortgagees interest in the property which is deductible as cost of acquisition under s. 48 of the Act. In the present case, we find that the mortgage was created by the assessee himself. It is not a case where the property had been mortgaged by the previous owner and the assessee had acquired only the mortgagors interest in the property mortgaged and by clearing the same he had acquired the interest of the mortgagee in the said property. The questions raised by the assessee in the application submitted under s. 256(2) of the Act do not, therefore, raise any arguable question of law and the said application was rightly rejected by the High Court. In the circumstances, even though we are unable to agree with the reasons given in the impugned order, we are in agreement with the order of the High Court dismissing the application filed by the assessee under s.256(2) of the Act.

The appeal is, therefore, dismissed. No order as to costs.

31. It is thus seen that the Hon'ble Supreme Court had held that where the mortgage had been created by the owner after he had acquired the property, the clearing of the mortgage by him prior to the transfer of the property would not entitle him to claim deduction under Section 48 of the Act because, in such a case he did not acquire any interest in the property subsequent to his acquiring the same."

5. The Assessee in the said case is a co-owner of the present Appellant/Assessee. Therefore, the present Tax Case is disposed of in same terms and the questions of law are answered against the Assessee and in favour of the Revenue. No costs.

Sd/-
Assistant Registrar(CCC)

//True Copy//

Sub Assistant Registrar

ssk.

To

1. The Registrar,
Income Tax Appellate Tribunal,
'B' Bench, Chennai.
2. The Assistant Commissioner of
Income Tax,
Circle I, Kumbakonam.
3. The Commissioner of Income Tax (Appeals)-XIII,
Chennai.

+1cc to Mr.M.Swaminathan, Advocate Sr.42453

T.C.No.2624 of 2006

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srg 08/01/2021

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