IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 13.7.2020

CORAM

THE HONOURABLE MR. JUSTICE T.S.SIVAGNANAM

AND

THE HONOURABLE MRS. JUSTICE V.BHAVANI SUBBAROYAN

TAX CASE APPEAL NOS.147 & 148 OF 2018

(heard through video conferencing)

Mrs.Padma ...Appellant in TCA No.147 of 2018
Mrs.Kavitha ...Appellant in TCA No.148 of 2018

Vs

The Income Tax Officer, Corporate
Ward 3(3), Chennai-34. ...Respondent in both the appeals

APPEALS under Section 260A of the Income Tax Act, 1961 against the common order dated 26.9.2017 made respectively in ITA. Nos.1104 & 1105/Mds/2017 on the file of the Income Tax Appellate Tribunal, Chennai 'B' Bench for the assessment year 2013-14 and against the order of the Commissioner of Income-Tax (Appeals)-II, Chennai-34, dated 27.02.2017 made in ITA Nos.295 & 301/2015-16/CIT(A)-11 and against the Income Tax Officer, Corporate Ward-3(3), Chennai-34, dated 29.02.2016, made in GIR No.AACPP2749R and GIR No.AACPK5957A respectively.

For Appellants : Mr.G.Baskar in both Cases

For Respondent : Mrs.V.Pushpa, SC in both Cases

COMMON JUDGMENT

(Judgment was delivered by T.S.SIVAGNANAM,J)

We have heard Mr.G.Baskar, learned counsel appearing for the appellants - assessees and Mrs.V.Pushpa, learned Standing Counsel appearing for the respondent - Revenue.

2. These appeals, filed by the assesses, who are sisters and legal heirs of late Mr.S.Shanmugam under Section 260A of the

Income Tax Act, 1961 (for short, the Act), are directed against the common order dated 26.9.2017 made respectively in ITA.Nos.1104 & 1105/Mds/ 2017 on the file of the Income Tax Appellate Tribunal, Chennai 'B' Bench (for brevity, the Tribunal) for the assessment year 2013-14.

3. The appeals were admitted on 03.4.2018 on the following substantial question of law :

> "Whether the sale of encumbered inherited property to discharge income tax liabilities as also loan liabilities of the original owner secured by a charge on that property would attract capital gains under Section 54 of the Income Tax Act, 1961?"

4. However, before making arguments in this appeal, the learned counsel on either side submit that there is a typographical error in the question framed and pray that this Court may suitably re-frame the question. With their consensus, the following substantial question of law is framed by us for consideration :

> "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 by overriding title in respect of the sale consideration directly paid by the purchaser to the Income Tax Department against the tax liability of the deceased father since the said properties were inherited by the appellant with encumbrance by way of attachment by the Income Tax Department ?"

5. The facts leading to filing of these appeals are as follows :

The assessees' father late Mr.S.Shanmugam acquired two properties in Chennai, the details of which are not germane for taking a decision in these appeals. The assessees' father, for business purposes, appeared to have taken loans from M/s.Lakshmi Vilas Bank (for short, the bank) and to secure the loan transaction, which, according to the Revenue, is a business loan, the two properties were mortgaged with the bank by deposit of title deeds. Since the assessees' father defaulted in repayment, the bank had initiated legal proceedings before the Debts Recovery Tribuna-3l (DRT) during the year 2007. On 13.2.2009, i.e. when the assessees' father was alive (he passed away on 23.1.2011), a search was conducted in the premises under

Section 132 of the Act and the assessments for the years 2003-04 to 2009-10 were reopened and upon completion of those assessments, a demand for Rs.13,39,17,742/- was raised against the assessees' father. The two properties in question were also attached by the Tax Recovery Officer.

6. The assessees' father died leaving behind the assessees as his legal heirs and their mother one Mrs.S.Gowri. The assessees and their mother, with a view to settle the bank liability and the arrears of income tax payable by the said late Mr.S.Shanmugam, worked out one time settlement with the bank and ultimately, the properties were sold (i) by a sale deed dated 03.5.2012 for a sale consideration of Rs.2 Crores and (ii) by a sale deed dated 11.3.2013 for a sale consideration of Rs.5 Crores. A part of the sale consideration was paid directly to the Income Tax Department in partial settlement of the dues payable by the assessees' father.

7. The assessees filed their return of income on 30.3.2015 admitting a total income of Rs.4,72,420/- and the returns were processed under Section 143(1) of the Act. The case was selected for scrutiny under Section 143(2) of the Act and a notice was issued to the assessees calling for particulars regarding the sale transactions. The Assessing Officer did not accept the stand taken by the assessees that since the properties were under attachment by the bank and the Income Tax Department, the sale/sale proceeds received resulted in diversion of entire consideration by overriding the title and that nothing had come to the hands of the assessees or their mother giving rise to any income by way of capital gains. This submission found favour with the Assessing Officer, who completed the assessments by two separate orders dated 29.2.2016 and added a sum of Rs.1,96,76,486/- as capital gains from the sale of the aforementioned two properties.

8. Aggrieved by such orders, the assessees preferred appeals before the Commissioner of Income Tax (Appeals)-11, Chennai-34 [for brevity, the CIT(A)]. Before the CIT(A), it was contended that the Assessing Officer failed to appreciate that the two properties in question were already attached by both (i) the bank during the life time of the father of the assessees for recovery of the loans availed by him as well as (ii) the Tax Recovery Officer to recover tax arrears due from him and that when the entire sale consideration on those two properties were paid by the vendees to the bank and to the Income Tax Department, there was diversion of the entire consideration by overriding the title resulting in no accrual or receipt of capital gains in the hands of the assessees.

9. Ultimately, the CIT(A), by a common order dated 27.2.2017, dismissed the appeals filed by the assessees in toto. The view taken by the CIT(A) was that the assessees were liable to pay long term capital gains tax, which the said late Mr.S.Shanmugam would have been liable to pay had he not passed away. Therefore, it was held that the assessees could not seek exemption from the same with an explanation that they did not have money after transfer of both the properties.

10. As against the common order dated 27.2.2017 passed by the CIT(A), the assessees preferred appeals before the Tribunal reiterating that no part of the sale consideration was actually received by the assessees. Before the Tribunal, the assessees placed reliance on the decision of the Hon'ble Supreme Court in the case of R.M. Arunachalam Vs. CIT [reported in (1997) 227 ITR 0222] in support of their contention that the payment made for the purpose of clearing the mortgage debt created by the assessees' father on the said properties should be considered as cost of improvement in respect of the said properties so as to prove the title of the properties inherited by the assessees.

11. With regard to the income tax liability, it was contended before the Tribunal that because of the charge created towards income tax liability, which was created during the life time of their father, the assessees having inherited the properties along with the charge, the settlement of income tax liability would, in effect, be an improvement to the cost of acquisition of the properties and that the same was liable to be considered when computing the capital gains in respect of the said properties.

12. So far as mortgage debt is concerned, the Tribunal held in favour of the assessees by concluding that the charge, admittedly, is a property specific and that the discharge of the said charge raised by the bank and the settlement thereof would be cost of improvement in respect of the said properties in the hands of the assessees, who inherited the properties.

13. Per contra, Mrs.V.Pushpa, learned Standing Counsel appearing for the respondent - Revenue submits that though this finding may not be fully right, yet the Revenue did not pursue the matter further by challenging that portion of the order of the Tribunal due to low tax effect.

14. Be that as it may, since there is no challenge to that portion of the order of the Tribunal, the Revenue cannot now seek to argue contrary to the said finding without a separate appeal or cross objection filed by them in these appeals. With regard to the second issue, namely the income tax liability, the Tribunal held against the assessees by concluding that the income tax liability is a personal liability of the father of the assessees - the said late Mr.S.Shanmugam and that no charge had been created by the said late Mr.S. Shanmugam on the said properties in respect of the income tax liability. Therefore, the Tribunal held that the payment made by the assessees to the Income Tax Department for settlement of tax liability of the said late Mr.S.Shanmugam from the sale consideration of the two properties inherited by them could not be considered as cost of improvement for the purpose of computing capital gains. Aggrieved by the common order passed by the Tribunal, the assessees are before us by way of these appeals.

15. Mr.G.Baskar, learned counsel appearing for the assessees, after reiterating the factual situation, submits that the fact remains that the assessees received nothing in their hands from and out of the sale price paid by the purchaser, that the amounts were directly remitted to the Income Tax Department for partial settlement of the dues and that this payment has to be construed as diversion by overriding the title as nothing had come to the hands of the assessees and nothing accrued to them.

16. The learned counsel appearing for the assessees has referred to Section 48 of the Act, which deals with the mode of computation of capital gains. A reference was also made to Section 159(6) of the Act with regard to the liability of legal representatives. It is, therefore, submitted that unless and until charge was created, the properties could not have been disposed of, that the remittance of the entire sale consideration to the Income Tax Department was diversion by overriding the title, that this would squarely fall within the meaning of Section 48(1) of the Act and that therefore, the Tribunal erred in not granting relief to the assessees.

17. Per contra, Mrs.V.Pushpa, learned Standing Counsel appearing for the Revenue submits that the crucial issue to be taken note of is as to when the liability of capital gains arises. The answer being that the liability of capital gains arises when the property is sold, that the assessees before this Court had good right and title over the properties, which they had sold, that the income tax liability was an individual liability of their father, that it has got nothing to do and

that settlement of the same can have no impact on the computation of capital gains.

18. The learned Standing Counsel appearing for the Revenue has laid emphasis on the expression "wholly and exclusively" occurring in Section 48(1) of the Act and submits that the expenditure incurred should be wholly and exclusively in connection with such transfer. It is pointed out that there was no compulsion on the part of the assessees to sell the properties and it was a voluntary decision taken by them to sell the properties and in that process, they settled a part of the income tax liability of their father and that the same cannot be construed as an expenditure incurred wholly and exclusively in connection with sale of the properties or can it be construed as cost of improvement to the properties sold.

19. In support of her contention, the learned Standing Counsel for the Revenue has referred to

> (i) the decision of the Hon'ble Supreme Court in the case of R.M. Arunachalam;
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> (ii) the decision rendered by us in the case of Kumar Rajaram Vs. ITO [reported in (2019) 110 Taxmann.com 109;
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> (iii) the decision of a Division Bench of this Court in the case of CIT. Vs. N.Vajrapani Naidu [reported in (2000) 241 ITR 0560]; and
>
> (iv) the decision of the Division Bench of this Court in the case of CIT Vs. S.A.S. Hotels Private Limited [reported in (2002) 124 Taxman. 663].

20. After elaborately hearing the learned counsel for the parties, we are of the considered view that the conclusion arrived at by the Tribunal is just and proper and legally sustainable. We support such a conclusion with the following reasons :

We need not labour much to do so, as we are guided by the decision of the Hon'ble Supreme Court in the case of R.M. Arunachalam. The question, which fell for consideration before the Hon'ble Supreme Court, was with regard to clearing the liability of estate duty by the legal heirs of the original owner and the effect thereon while computing capital gains and as to whether the same can be claimed as a deduction as 'cost of acquisition' or as 'cost of improvement'. The Hon'ble Supreme

Court held that the amount proportionate to estate duty paid by the assessee on the properties that were transferred could not be treated as ‘cost of acquisition’ under Sections 48 and 49 read with Section 55(2) of the Act since the title of the assessees to the immovable properties acquired was not incomplete and imperfect in any way.

21. The operative portion of the judgment in the case of R.M. Arunachalam is as follows :

> “This would show that a charge differs from a mortgage in the sense that in a mortgage there is transfer of interest in the property mortgaged while in a charge no interest is created in the property charged so as to reduce the full ownership to a limited ownership. The creation of a charge under section 74(1) cannot, therefore, be construed as creation of an interest in property that is the subject-matter of the charge. The creation of the charge under section 74(1) only means that in the matter of recovery of estate duty from the property which is the subject-matter of the charge the amount recoverable by way of estate duty would have priority over other liabilities of the accountable person. In that sense the claim in respect of estate duty would have precedence over the claim of the mortgagee because a mortgage is also a charge. [See State Bank of Bikanerdi Jaipur v. National Iron & Steel Rolling Corpn. 1995 (2) SCC 19]. The High Court has, therefore, rightly held that as a result of the charge created under section 74(1), it would not be said that title of the assessee to the immovable properties received by him from Smt. Umayal Achi was incomplete and imperfect in any way. In the context of the facts of this case, the High Court has found that the assessee had admittedly become the full owner of the assets even before the payment of estate duty and on payment of the same he had not acquired a new right, tangible or intangible, in the assets. It cannot, therefore, be said that the amount proportionate to estate duty paid by the assessee on the properties that were transferred should be treated as 'cost of acquisition of the assets' under sections 48

> and 49, read with section 55(2). Since the title of the assessee to the immovable properties acquired was not incomplete and imperfect in any way, it cannot also be said that as a result of the payment of the estate duty by the assessee there was an improvement in the title of the assessee and the said payment could be regarded as 'cost of improvement' under section 48, read with section 55(1)(b)."

22. The decision of the Hon'ble Supreme Court in the case of R.M.Arunachalam was considered in the decision of this Court in the case of N.Vajrapani Naidu where the substantial question of law arose was as to whether the amount paid for discharging the debts due to mortgage of the property in connection with transfer of property should be deducted in computing the capital gains arising from the transfer of the property. The question was answered in the following terms :

> "6. The Supreme Court in the case of R. Arunachalam v. CIT [1997] 227 ITR 222/ 93 Taxman 423 had an occasion to consider the question as to whether the sum paid by the assessee for discharging the mortgage by the assessee is a sum which would go to reduce the cost of acquisition. The Court held that 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 Court further observed in that case as under :
>
> ". . . 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."
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> 7. It is undisputed that in this case, 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 the consideration to the sale. The distinction that was sought to be made by the Tribunal between the case where the mortgage is discharged by the vendor prior to the sale and the case where the discharge of the mortgage is effected at the time of the sale by payment of the outstanding amount to the mortgagee by the vendor and the sale is free from encumbrances, is untenable. The only point of relevance is whether the mortgage was created by the vendor or whether it sustained at the time of acquisition of title thereto by the vendor and was burdened with the same at the time of such acquisition of title."

23. The decision of the Hon'ble Supreme Court in the case of R.M.Arunachalam was also relied upon in the decision of this Court in the case of S.A.S. Hotels Private Limited where the question was as to whether the payment of urban land tax and corporation tax by the owner would form part of 'cost of acquisition'. It was held that payment of such tax on land by the owner did not form part of the 'cost of acquisition' nor it was part of expenditure incurred by the owner in connection with transfer and that payment of tax also did not amount to improvement of land. With these findings, the Hon'ble Division Bench set aside the finding of the Tribunal and answered the substantial question of law in favour of the Revenue.

24. Very recently, the Hon'ble Division Bench of this Court in the case of D.Zeenath Vs. ITO [reported in (2019) 105 Taxman.com 298] considered a more or less identical substantial question of law namely whether the Tribunal was right in not appreciating that no part of the consideration for sale was received by the appellant/assessee and the same was directly paid to the bank by the purchaser in discharge of the mortgage amount and therefore, no capital gains arise in the hands of the assessee and as to whether the Tribunal was right in law in not holding that there was diversion of sale proceeds towards redeeming the interest of the mortgagor and therefore, the amount so diverted was not liable to capital gains tax. The Hon'ble Division Bench of this Court applied the ratio in the decision of the Hon'ble Supreme Court in the case of R.M.Arunachalam, which position stood reiterated in the decision of the Hon'ble Supreme Court in the case of

V.S.M.R.Jagadishchandran (decd.) Vs. CIT [(1997) 227 ITR 420]. The Court also noted that the Tribunal had followed the decision of the Kerala High Court in the case of Ambat Echukutty Menon Vs. CIT [reported in (1978) 111 ITR 880] and the decision of this Court in the case of CIT Vs. Indira [reported in (1979) 119 ITR 837] wherein it was held that clearing off mortgage debt could never be treated as 'cost of acquisition' nor as 'cost of improvement' by the assessee. A reference was also made to the Full Bench of this Court in the case of S.Valliammai Vs. CIT [reported in (1981) 127 ITR 713].

25. In the latest decision of this Court in the case of D.Zeenath, the Court further noted the decision of this Court in the case of Sri Kanniah Photo Studio Vs. ITO [reported in (2016) 286 CTR 538], which followed the decision of the Hon'ble Supreme Court in the case of R.M.Arunachalam and approved the same. In the decision in the case of Sri Kanniah Photo Studio, it had been held that as the burden had been created for his own benefit by offering the property as security to the bank, the amount spent for discharging that burden whether prior to sale, or at the time of sale, by way of one-time settlement to the bank, cannot be regarded as expenditure wholly and exclusively in connection with the transfer.

26. We find that the argument of Mrs.V.Pushpa, learned Standing Counsel appearing for the Revenue that the finding of the Tribunal in so far as the mortgage debt with the bank is concerned is erroneous and appears to stem from the decisions in the case of V.Indira, Ambat Echukutty Menon and S.Valliammai.

27. As pointed out earlier, the Revenue did not file a separate appeal against the said finding, which went in favour of the assessee nor there is any cross objection in these appeals filed by the Revenue. Therefore, we cannot adjudicate the correctness of the finding rendered by the Tribunal in this regard. The aforementioned discussion can lead to the only answer by holding that the case on hand is not a case of diversion of sale proceeds by overriding title in respect of the sale consideration, which was directly paid to the Income Tax Department.

28. The Revenue is right in contending that the liability to pay capital gains tax arises on the sale of the properties and on the date when the property was sold, the assessees had right, title and interest over the properties and the sale was voluntary.

29. Mr.G.Baskar, learned counsel appearing for the appellants - assessees has relied upon Section 159(6) of the Act with regard to the liability of the legal representatives and submits that it shall be subject to the provisions of Sub-Section (4) and Sub-Section (5) of Section 159 of the Act.

30. However, we find that no such contention was advanced before the Tribunal and this appears to have been advanced before this Court for the first time. In any event, the liability has been shared proportionately among the legal heirs of the said late Mr.S.Shanmugam. Therefore, reliance on Section 159(6) would not render any assistance to the case of the assessees.

31. For all the above reasons, the tax case appeals are dismissed and the substantial question of law is answered against the assessees. No costs.

Sd/-
Assistant Registrar(CS IV)

//True Copy//

Sub Assistant Registrar

RS

To

1.The Income Tax Appellate Tribunal, Chennai 'B' Bench.

2.The Income Tax Officer, Corporate Ward 3(3), Chennai-34.

3.The Commissioner of Income-Tax(Appeals)-II, Chennai-34.

4.The Assistant Registrar, Income Tax Appellate Tribunal, Rajaji Bhavan, Besant Nagar, Chennai.

+1cc to M/s.G.Baskar, Advocate, S.R.No.24660

TCA.Nos.147 & 148 of 2018

BR(CO)

KKV/18/08/2020