

Kerala High Court

Commissioner Of Income-Tax vs Smt. Thressiamma Abraham (No. 1) on 16 September, 1996

Equivalent citations: 1997 227 ITR 802 Ker

Author: V Kamat

Bench: V Kamat, K N Kurup

JUDGMENT V.V. Kamat, J.

1. The following three questions expect our answer at the instance of the Revenue :

" 1. Whether, on the facts and in the circumstances of the case, the Tribunal is justified in law in interfering with the assessment under the head 'Capital gains' for any of the reasons stated in the order ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal is right in law and fact in holding -

'since the expenditure in this case is only the acquisition of full ownership prior to act of transfer of property which stood diminished by reason of transfer of some interest in the property by way of mortgage, the expenditure in question is an expenditure incurred for the purpose of transferring the full ownership rights in the property' and are not the above findings wrong, unreasonable, illogical and against law and the expenditure impermissible ?'

3. Whether, on the facts and in the circumstances of the case, the assessee is entitled to the deduction of the amount paid to the Kerala Financial Corporation for discharge of mortgage as deduction under Section 48(1)(a)(i) from the sale consideration and is not the finding wrong and the deduction impermissible in the light of the Kerala High Court decision in the case of Ambat Echukutty Menon [1978] 111 ITR 880 and the Supreme Court decision in the case of CIT v. George Henderson and Co. Ltd. [1967] 66 ITR 622 ? "

2. The assessee is before us in her capacity as a guarantor. It appears that she was assessed to wealth-tax, which was the basis of information of the Income-tax Officer to the effect that land admeasuring 1.74 acres in Palarivattom within the limits of the Cochin Corporation became the subject-matter of sale. On this information, a notice was issued and a "nil" return was filed, besides agricultural income. The return was accompanied by a note. The contents of the said note are vital enough and they are as follows :

" The Palarivattom property was mortgaged to the Kerala Financial Corporation and the entire consideration was paid to discharge the debts and hence after deducting relief under Section 54E what has been sold was only the equity of redemption inasmuch as the property has been mortgaged to the Kerala Financial Corporation and, therefore, the amount paid by the vendor direct to the Kerala Financial Corporation. Thus discharging this debt cannot be considered as consideration received or accruing to your petitioner.

The Transfer of Property Act recognises that ownership is a bundle of rights and when a property is mortgaged, some interest in property is transferred with the result that the owner of the mortgaged property becomes a limited owner. Consequently, when the property was sold subject to that mortgage, the sale was only your petitioner's limited ownership and the secured creditor was entitled to receive the payments in discharge of the mortgage from the transferee with notice. So the amount paid directly to the Kerala Financial Corporation cannot be considered to be part of the consideration paid to your petitioner at all, not only because your petitioner did not actually receive it, but also because your petitioner was not entitled to receive it since the amount had to be given to the Kerala Financial Corporation by overriding title in respect of their interest in the property created by the mortgage.

Section 73 of the Transfer of property Act provides that where a mortgaged property is sold, in the sale the mortgagee shall be entitled to claim payment of the mortgage money out of the sale proceeds and the mortgagee has also a prior claim over other creditors. Thus the law relating to the transfer of property recognises the right of the mortgagee to receive payment directly in discharge of the debts when a property is sold. Your petitioner is filing herewith a certificate issued by the Kerala Financial Corporation regarding the release of the property and the consideration received by them. So the entire amount paid direct to the Kerala Financial Corporation or accrued to the Kerala Financial Corporation and not your petitioner cannot be considered as consideration paid for the transfer of the property.

Alternatively, the amount paid for discharging the debts was an expenditure incurred wholly and exclusively in connection with the transfer. So the payment to the Kerala Financial Corporation whose interest was secured, is eligible as a deduction in computing the net consideration. Hence, sale proceeds are not liable for assessment."

3. Reading the contents of the above note it would appear that the property was the subject-matter of a mortgage in favour of the Kerala Financial Corporation. It would also appear that the sale was in exercise of rights of the said financial corporation under the document of mortgage. It is contended that in exercise of this right in the matter of discharge of the debt under the mortgage deed, what was sold was the equity of redemption in view of the undisputed situation that the property had been mortgaged to the Kerala Financial Corporation. The Income-tax Officer did not find any relevance in the process of assessment of capital gains. He has observed that the assessee stood as a guarantor for the loan given by the Kerala Financial Corporation to the National Tyre and Rubber Co. India Ltd. and in pursuance of this position of the assessee as a guarantor, the property was mortgaged under a deed dated September 22, 1969, in favour of the Kerala Financial Corporation for the loan obtained by the National Tyre and Rubber Co. India Ltd. The Income-tax Officer also did not dispute that the entire sale proceeds of this property went in appropriation towards the relinquishment of the charge by the Kerala Financial Corporation. The Income-tax Officer has also noted that in the matter of the loan granted by the Kerala Financial Corporation to the National Tyre and Rubber Co. India Ltd. under the document giving the right to the Kerala Financial Corporation to exercise for realisation of the debt by sale of the property in question for appropriation towards the loan granted by the Corporation.

4. The Income-tax Officer held that the assessee purchased the property in 1964 and for the assessment year 1974-75, its value was shown as Rs. 50,000 in the wealth-tax return. This property was mortgaged in favour of the Kerala Financial Corporation for the loan taken by the National Tyre and Rubber Co. India Ltd. and on the National Tyre and Rubber Co, India Ltd. defaulting payment of loan, under the document the Kerala Financial Corporation sold the property and its sale proceeds were appropriated towards the loan taken by the National Tyre and Rubber Co. India Ltd. It appears that the National Tyre and Rubber Co. India Ltd.

credited the sale value in their accounts under the head "Schedule of unsecured loans".

5. In these circumstances in view of the fact that the sale proceeds are credited in the assessee's name in the accounts of the National Tyre and Rubber Co. India Ltd., the Income-tax Officer held that the assessee should be deemed to have received the entire sale proceeds. The sale proceeds amounted to Rs. 13,12,414 and from the said amount deducting Rs. 50,000, the amount of capital gains was computed at Rs. 12,62,414. This was by the order dated December 21, 1989.

6. The Commissioner of Income-tax (Appeals) dealt with the proceedings as the first appellate authority. The Commissioner recorded a finding that the assessee had no direct or indirect liability to be discharged. However, the Commissioner endorsed the finding of the Income-tax Officer that the assessee was a creditor in the accounts of the National Tyre and Rubber Co. India Ltd. The reasoning proceeded further to specify that the National Tyre and Rubber Co. India Ltd. was liable to pay some dues to the Kerala Financial Corporation. Although the Commissioner has observed that the assessee had permitted to mortgage her property to the Kerala Financial Corporation for helping the National Tyre and Rubber Co. India Ltd. to take the loan from the Kerala Financial Corporation, the relationship will have to be termed as having been described in the language of a layman. There is a regular document on record and as regards the contents thereof there can hardly be any dispute between the two sides. Still the Commissioner observes that no charge was created on the property by the Kerala Financial Corporation. A contention was raised before the Commissioner that the assessee had no liability to discharge in the context of the situation in regard to which the Commissioner observed that although there was no personal obligation on her to discharge the liability of the National Tyre and Rubber Co. India Ltd., still there was a constructive receipt of the entire money by the assessee. It is on the basis of the above reasoning in a general manner that the first appellate authority confirmed the order of the Income-tax Officer.

7. The assessee carried the proceedings before the Income-tax Appellate Tribunal, Cochin Bench. The Tribunal has considered the position basically with reference to the position and relationship between the parties in the light of the contents of the document dated September 22, 1969.

8. After hearing learned senior tax counsel at length as well as learned counsel for the assessee, we find it really necessary and vital to understand the parties in the light of their relationship as spelt out in the above document, as summarised by the Tribunal in paragraph 6 of its order. We state so because once this relationship between the parties, which is the factual peculiarity of the proceedings, is understood and appreciated with reference to the necessary and inevitable consequences therefrom, we would be able to separate the wheat from the chaff with reference to

the reasoning of the Tribunal because it appears that the parties have taken the Tribunal through the circuitous ways, when things with reference to the factual peculiarities obviously did not require that circuitous and involved approach-Following the destruction of the factory of the National Tyre and Rubber Co. India Ltd., there was an order dated July 27, 1965, of voluntary liquidation. Reconstruction and revival of the factory was an inevitable consequence. The National Tyre and Rubber Co. India Ltd. raised a loan of Rs. 20 lakhs from the Kerala Financial Corporation and for that purpose mortgaged its properties. As is fairly known, the Kerala Financial Corporation got reinforced with the assessee as a guarantor.

9. The document dated September 22, 1969, describes the property in question in Schedule C thereof. The National Tyre and Rubber Co. India Ltd. is shown as mortgagor-company, the assessee is shown as guarantor and co-mortgagor, the deed is in favour of the Kerala Financial Corporation.

10. It is clearly stated in the deed (page 8 thereof) that at the request of the mortgagor company, the co-mortgagor and the guarantors, the Kerala Financial Corporation has agreed to lend an advance of Rs. 20 lakhs to the National Tyre and Rubber Co. India Ltd. The mortgagor-company and the guarantors and co-mortgagors guaranteed the repayment of Rs. 20 lakhs to the Kerala Financial Corporation.

11. The document (pages 16 and 17) spells out the terms of redemption of the mortgage. The mortgagor-company and the co-mortgagor are prohibited to sell the property mortgaged during the continuance of the mortgage. In addition thereto, an absolute right was given to the Kerala Financial Corporation to sell the property mortgaged in the event of failure to repay the loan amounts which is specifically to be found at page 43 of the document. Not content with this position, as per Section 69 of the Transfer of Property Act, 1882, as to be found at page 45 of the document, power to sell the mortgaged property without the intervention of the court in default of payment of the mortgage debt also forms part of the document. In addition thereto, the document also provides that the guarantee, as far as the assessee is concerned, is enforceable as if the guarantor is the principal debtor with reference to all the payments and covenants guaranteed by them and further the guarantee is irrevocable in nature.

12. Factually, the Tribunal has also recorded that the Kerala Financial Corporation on various dates released the mortgaged properties ; illustratively on December 15, 1981, the Kerala Financial Corporation released 88 cents from the mortgage on receipt of Rs. 7,04,000 from Sri L. K. Prabhu. Another piece of land was released on January 22, 1982, on receipt of Rs. 6,88,000 with an addition that in the accounts of the National Tyre and Rubber Co. India Ltd. this is shown to have been debited to the account of the Kerala Financial Corporation with simultaneous credit having, been shown accordingly. The Tribunal has also observed, as far as the assessee is concerned, situation of contra-credits in the account of the assessee as account showing payment to the Kerala Financial Corporation for release of the land from mortgage. In the process of reasoning, the Tribunal has referred to the rights of the assessee in a situation when the loan amount was paid directly by the buyers out of the sale proceeds through draft to the creditors, stating that in her capacity as surety, the assessee would have the legal right to enforce against the debtor--National Tyre and Rubber Co. India Ltd.--the rights that the creditor enjoyed in regard to the debt in question.

13. The Tribunal has recorded the undisputed factual position that no amount was received by the assessee. The entire sale consideration was paid directly to the Kerala Financial Corporation by the purchasers and it was thereafter only that the mortgaged property was released as can be seen from the letter of the Kerala Financial Corporation dated December 15, 1981, and January 22, 1982. The Tribunal has made the situation more specific that the sale consideration was diverted to the Kerala Financial Corporation by overriding title.

14. It is in this process of reasoning the Tribunal observed that the two authorities would have to be dealt with with regard to their reasoning in the light of the factual peculiarities.

15. In fact, if these undisputed factual peculiarities are taken into consideration, we fail to understand as to how it could be said with reference to the facts that there has been any income to the assessee much less the capital gains in regard thereto.

16. What would constitute capital gains is basic to the situation and the provisions of Section 45 of the Income-tax Act, 1961, tell us what would constitute as chargeable to income-tax under the head "Capital gains", to be deemed to be the income of the previous year in which the transfer took place. Capital gains would have to be understood as profits or gains arising from the transfer of a capital asset, otherwise provided in Sections 53, 54, 54B and all that.

17. In the first instance, the undisputed factual matrix in the context shows that the assessee received not a pie as a result of the transfer under consideration. We have spelt out the contents of the document hereinbefore and the undisputed factual matrix in regard thereto. This reveals that with regard to the liability to the tune of Rs. 20 lakhs in an activity undertaken by the Kerala Financial Corporation under the rights with reference to the documents in question, only an amount of Rs. 13,12,414 were the sale proceeds. The situation also undisputedly shows that the entire amount went into the process of appropriation of the mortgage debt under the document.

18. We have quoted the factual findings in regard to the crucial situations.

19. The factual situation shows that the Kerala Financial Corporation acted in exercise of the rights arising out of the document against the assessee who was in the position of a guarantor. There is no dispute as regards the legal position that the guarantor and the debtor are in the same position. Additionally, the various peculiarities of the document discussed by us hereinbefore clearly go to show that the Kerala Financial Corporation was in seisin of an absolute right to sell the mortgaged property in the event of failure to repay the loan amount. In our judgment, the factual position with reference to the various aspects appearing from the document in question shows that the Kerala Financial Corporation acted in exercise of overriding title in its favour.

20. When this situation presented no difficulty actually, the Income-tax Appellate Tribunal appears to have been proceeding in wholly unnecessary directions. In the process of reasoning the Tribunal considered the statutory provisions relating to deduction from the full value of the consideration by resort to Section 48 of the Income-tax Act, 1961. We will have to see Section 2(47) of the Act which tells us what is to be understood by "transfer" in relation to a capital asset. This inclusive definition

brings within it not only the sale, exchange or relinquishment, but also extinguishment of any rights in the property or the compulsory acquisition of the property under any law relating to acquisition of property by the State. In fact Section 45 of the Act, after telling us what is to be understood as capital gains, as the starting statutory section dealing with the subject "capital gains" subsequent sections really deal with situations to be considered in regard thereto. Illustratively Section 46 deals with the situation of distribution of the assets of a company on its liquidation. Section 47 tells us the situations of transfer which would not be governed by the provisions of Section 45. Illustratively such situations are statutorily available in Section 47. Thereafter Section 48 tells us the process of computation of capital gains with reference to the income chargeable in regard thereto. It enacts two facets of deduction : one relates to the expenditure relating to the transfer and the other to the cost of acquisition of the capital asset and the cost of any improvements in regard thereto.

21. The Tribunal by a process of reasoning considered the provisions of Section 48(1) relating to the expenditure wholly or exclusively in connection with such transfer. In the process of reasoning the Tribunal has considered the relevant case law to record the conclusion that this would be a situation governed by Section 48(1)(a)(i) of the Act. In the process of reasoning the Tribunal relies on the decision of the apex court in Attar Singh Gurmukh Singh v. ITO [1991] 191 ITR 667 and the decision of this court in V. A. Vasumathi v. CIT [1980] 123 ITR 94. The decision of the apex court in Attar Singh Gurmukh Singh v. ITO [1991] 191 ITR 667, considers the situation that the word "expenditure" has not been defined and, therefore, should be considered as a word of wide import, with a necessary note that the court cannot be oblivious of the proliferation of black money which is under circulation in our country, and any restraint to curb the chances and opportunities to use or create black money should not be regarded as curtailing the freedom of trade or business. In fact after going through the decision we are unable to satisfy ourselves as regards its relevance in the context of factual peculiarities. The decision of this court in Vasumathi's case [1980] 123 ITR 94, deals with the position of compulsory acquisition of land and in regard thereto expenditure on litigation for getting enhanced compensation in the context of the contention of it being expenditure wholly or exclusively incurred in connection with the transfer of the capital asset and its deductibility. There is no dispute with regard to the propositions and it will have to be said that the factual matrix determines the consequential situation without any difficulty.

22. Learned senior tax counsel strenuously submitted that the Tribunal in its reasoning has tried to fit the situation in the four corners of Section 48(1)(a)(i) and has not considered inevitable situations in the light of the admitted and undisputable factual matrix. Thus learned counsel urged that this court must act within the limits of the questions to be answered and should not travel beyond the scope of the referable questions. We have already observed hitherto more than once of a meaningful approach in the context of time and situation, especially the observations are with reference to factual peculiarities, leaving no questions of dispute and answers creating no difficulty as a logical situation in regard thereto. Reading the contents of the document which have been sufficiently dealt with by the Tribunal, we pointedly asked learned senior tax counsel as to whether the Kerala Financial Corporation was acting on the basis of the overriding title, in other words, a situation of stepping into the shoes. Learned senior tax counsel reiterated his submission with regard to our limits. We find and record that this situation is without any answer on the merits. Learned senior tax counsel submitted that even this would not make any difference. We do not agree

because it is this situation that goes to the root of the matter and is obviously without any answer.

23. In the light of the above discussion, in our judgment, only question No. 1 is required to be answered and that too on the basis of the reasoning that we have recorded and to the effect that the Tribunal is justified in law in interfering with the assessment.

24. In fairness to learned senior tax counsel he placed reliance on the decision of this court in *Ambat Echukutty Menon v. CIT* [1978] 111 ITR 880 in the first instance. He also relied on two other decisions of this court [*Salay Mohamad Ibrahim Sait v. ITO* [1994] 210 ITR 700 and *K. V. Idiculla v. CIT* [1995] 214 ITR 386]. In our judgment, in the situation of the view that we have taken, it is not necessary to refer in great detail to the decisions cited. We may state that in *Ambat Echukutty Menon's* case [1978] 111 ITR 880, the facts are entirely different as the question was relating to the amount paid by the assessee to discharge the encumbrance and in the context whether it was incurred for improvement of the asset. In *Salay Mohamad's* case [1994] 210 ITR 700 (Ker) the question was of deductions in computation of the capital gains with reference to the amounts not diverted at source by overriding title. The situation before us is entirely different. Similarly, in *Idiculla's* case [1995] 214 ITR 386 (Ker), this court was concerned with the situation of deductions. We have before us the basic question as to whether capital gains arise on undisputed factual matrix.

25. For all these reasons, we answer question No. 1 in the affirmative, against the Revenue and in favour of the assessee. We decline to answer questions Nos. 2 and 3 in view of our reasoning.

26. A copy of this judgment under the seal of the court and the signature of the Registrar shall be forwarded to the Income-tax Appellate Tribunal, Cochin Bench, as required by law.