Andhra High Court
Commissioner Of Income-Tax vs Nawab Hashim Jah on 13 April, 1988
Equivalent citations: 1989 175 ITR 203 AP
Author: J Rao
Bench: B J Reddy, J Rao
JUDGMENT Jagannadha Rao, J.

1. This is a reference made at the instance of the Commissioner of Income-tax. The question referred is as follows :

"Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was correct in holding that only the proportionate value of the ALV of the property under consideration would attract the provisions of Section 64(1)(iv) of the Income-tax Act, 1961 ?"

2. In two appeals filed by the assessee before the Tribunal in relation to the assessment years 1974-75 and 1976-77, a common question arose regarding the income from the property to be added in the assessment of the assessee, Nawab Hashim Jah, under Section 64 of the Income-tax Act (hereinafter referred to as "the Act"). The assessee had transferred the house purchased by him from the Housing Accommodation Trust in favour of his wife, Muktar Begum, on March 5, 1973, for a purported consideration of Rs. 49,000. The Income-tax Officer proposed to include the annual letting value (ALV) of the above property in the assessment of the assessee, viz., the transferor, under Section 64, inasmuch as the transferee was none other than the wife of the transferor. By a letter dated November 21, 1978, the assessee-husband objected to the above proposal and also stated that without prejudice to his above objection, he had made a gift of Rs. 10,000 to his wife in August 1967, that his wife had invested the above-said amount in the purchase of 82 MICO shares, that the above shares were sold by her in March 1973, for a sum of Rs. 36,516 and that even if Section 64 were to be applied, only the proportionate annual letting value to the extent of Rs. 10,000 which was originally gifted by the assessee to his wife could be assessed and that it was not proper to include the entire annual letting value of the property. The Income-tax Officer passed orders on March 10, 1979, rejecting the contention of the assessee, These were contained in orders passed under Section 143(3) for the assessment year 1976-77 and orders passed under Section 143(3) read with Section 263 for the assessment year 1974-75. He held that the assessee's wife did not adduce any evidence to support the contention that she gave the balance, viz., Rs. 12,484 from her own monies. He also found that considering the value of the house, viz., Rs. 49,000, the net annual letting value of the property can be estimated at Rs. 7,500 clear of municipal taxes. On appeal, the said order was confirmed by the Appellate Assistant Commissioner. When the matter came to the Tribunal, the assessee pointed out that out of the total consideration of Rs. 49,000 for the sale deed dated March 5, 1973, executed by him in favour of his wife, Rs. 36,516 was paid by his wife out of monies realised by her from sale of her own 82 MICO shares. She had purchased these shares by utilising a sum of Rs. 10,000 given to her in August 1967. So far as the remaining consideration of Rs. 12,484 is concerned, it was supported by a promissory note dated December 25, 1971. On this basis, the assessee argued that the annual letting value of the property which could be included under Section 64 of the Act should only be in respect of that part of the property which could be said to have been transferred by the assessee to his wife otherwise than for adequate consideration.

Reliance was placed for the assessee on the judgment of the Division Bench of this court in CIT v. Pelleti Sridevamma . On the other hand, the Revenue relied upon certain other rulings for repelling this contention. So far as the loan of Rs. 12,484 is concerned, it was found that the said amount did not belong to the wife as contended. The question was, therefore, limited to the aspect whether the proportionate annual letting value alone was includible or whether the entire annual letting value was includible. While, according to the assessee, out of the remaining consideration of Rs. 36,516, proportionate annual letting value only in a sum of Rs. 10,000 is to be included, the Revenue contended that the annual letting value relating to not only Rs. 10,000 but also to the remaining Rs. 26,516 (in other words, in respect of the entire Rs. 36,516) had to be included in the assessment of the assessee. On a consideration of the relevant provisions and the rulings submitted, the Tribunal came to the conclusion that out of Rs. 36,516, only the annual letting value relating to Rs. 10,000 is to be included and not the annual letting value relating to the remaining amount of Rs. 26,516.

3. We may point out that so far as the balance amount of Rs. 12,484 is concerned, the decision of the Tribunal has not been challenged before us by either party.

4. The question, therefore, is :

Whether under Section 64 of the Act, the annual letting value referable to the entire amount of Rs. 36,516 is to be included in the income of the assesses, viz., the husband, or whether, as held by the Tribunal, only the annual letting value relating to Rs. 10,000 supplied by the husband earlier to the wife should be included ?

5. From the facts set out above, it is clear that the assessee-husband had given a cash gift of Rs. 10,000 to his wife in August 1967. This money was invested by the wife in the purchase of 82 MICO shares and these shares were ultimately sold by her in March 1973, for Rs. 36,516 and this sum became part of the consideration paid by her to her husband (the assessee), for sale of the house on March 5, 1973, by the husband in her favour. While the assessee-husband contends that the annual letting value in respect of the house proportionate to Rs. 10,000 out of Rs. 36,516, alone is includible under Section 64 of the Act in his assessment, the Department contends that the entire annual letting value referable to the total amount of Rs. 36,516 is to be included in the assessment of the assessee-husband.

6. The provisions of Section 64 of the Income-tax Act, as it stood then and in so far as they are relevant for the present purpose, read as follows :

"Section 64(1). In computing the total income of any individual, there shall be included all such income as arises directly or indirectly-

(iv) Subject to the provisions of Clause (i) of Section 27, in a case not falling under Clause (i) of this Sub-section, to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart ; .. .

Explanation 3.--For the purposes of Clauses (iv) and (v) where the assets transferred directly or indirectly by an individual to his spouse or minor child or invested by the spouse or minor child in any business, that part of the income arising out of the business to the spouse or minor child in any previous year, which bears the same proportion to the income of the spouse or minor child from the business as the value of the assets aforesaid as on the first day of the previous year bears to the total investment in the business by the spouse or the minor child as on the said day, shall be included in the total income of the individual in that previous year ..."

7. Section 64 of the Act aims at foiling an individual's attempt to avoid or reduce the incidence of tax by transferring assets to the spouse or minor child or adopting any other modes covered by the said section. Under sub- Clause (iv) of Section 64(1), it is provided that in computing the total income of the assessee, there shall be included all such income as arises directly or indirectly to the spouse of the assessee from assets transferred directly or indirectly to the spouse by the assessee otherwise than for adequate consideration or in connection with an agreement to live apart, subject, however, to the provisions of Section 27(i) and in a case not falling under Clause (i) of Section. 64(1) of the Act. It will be noticed that the words "directly or indirectly" have been used twice in the relevant portion applicable to the present case, once in the main part of Section 64(1) and again in Sub-clause (iv). In other words, if the assessee has transferred assets directly or indirectly to the spouse, Clause (iv) will be attracted and it does not also matter whether the income from such assets has arisen directly or indirectly to such spouse from such assets so transferred.

8. We can visualise two types of cases of transfer by an assessee to the spouse. There may be cases where the immovable property belonging to the husband is gifted to the wife and she realises some income therefrom or realises money by selling it. Alternatively, the assessee might have gifted cash to his wife and she might have acquired immovable property with that money which would have furnished income in her favour or she might have later sold the immovable property and realised money. The question arises whether the income arising from the property so purchased or the money so realised by the sale thereof subsequently should by included in the income of the assessee. Such a question arose, in fact, in Mohini Thapar v. CIT [1972] 83 1TR 208 (SC).

9. So far as the former type of cases is concerned, it is not in dispute before us that they will be cases of assets transferred directly by the assessee to his spouse and such property furnishing income directly. There is no difficulty that the income in such cases is includible in the income of the transferor-assessee. The question, however, arose in the latter type of cases where the assessee merely gifted cash to his wife and she purchased some property with that money, whether the income arising from such property or the money realised by sale of such property should be relevant in considering the income of the assessee. Such a question arose, as already stated, in Mohini Thapar's case . There, the assessee made certain cash gifts to his wife and from out of these cash gifts, she purchased certain shares and invested the balance in deposits. The question was whether the income derived by the assessee's wife from the deposits and shares should be assessed in the hands of the assessee-

husband under Section 16(3)(a)(iii) of the Indian Income-tax Act, 1922, corresponding to the provisions of Section 64(1)(iv) of the present Act of 1961. The Supreme Court held that the transfers

in question were direct transfers and the income realised by the wife was income indirectly received in respect of the transfer of cash directly made by the assessee. They also observed that there was a proximate connection between the income and the transfer of assets made by the assessee and that the income derived by the assessee's wife had, therefore, to be included in the total income of the assessee under Section 16(3)(a)(iii). It will be noticed that the Supreme Court considered the cash gift to be a direct gift but held that the income arising out of the deposits and shares was an indirect income received by the wife. In other words, while the transfer was a direct transfer by the husband in favour of the wife, the income was an indirect income which the wife earned by investing the same in deposits and shares. The Supreme Court atso observed in that case that there was proximate connection between the income and the transfer of assets made by the assessee. Basing on the said decision of the Supreme Court in Mohini Thapar's case , it is argued by Sri M. Suryanarayana Murthy for the Revenue that the entire annual letting value of Rs. 36,516 is to be computed as the income of the assessee-husband and not merely the proportionate annual letting value for the sum of Rs, 10,000 originally gifted by the husband to the wife earlier.

10. In our opinion, this contention must prevail. As in Mohini Thapar's case above referred to, the case before us is also one of a cash gift of Rs. 10,000 in August 1967, which the wife invested in MICO shares and from which she realised Rs. 36,516 in March 1973, and the said sum was part of the consideration for the purchase of the house by her on March 5, 1973, from her husband. In our view, the gift of Rs. 10,000 was a direct gift by the husband-assessee in favour of his wife in August, 1967, and the said gift was substituted by the wife by the 82 MICO shares purchased by her and again substituted by the house property purchased by her on March 5, 1973. The annual letting value which arose from the said house property must be treated as an indirect income which accrued to the wife from the property transferred and the said amount is to be computed as the income of the husband. As in Mohini Thapar's case , there is a direct transfer of an asset by the assessee to his wife and an indirect income accruing to the wife from the said property which is to be assessed as the income of the transferor-assessee.

11. It is, however, argued by Sri Y. Ratnakar, learned counsel for the assessee, that there are certain observations in the aforesaid judgment of the Supreme Court in Mohini Thapar's case which require that there must also be a proximate connection between the income accruing to the spouse and the transfer of the assets by the asses see to the said spouse. He also refers to the principle of proximate connection stated by the Supreme Court in an earlier case in CIT v. Prem Bhai Parekh , which was followed in Mohini Thapar's case. We may point out that in Prem Bhai's case , a principle of proximate connection was no doubt laid down by the Supreme Court on the peculiar facts of that case. There, the assessee who was a partner in a firm having 7 annas share, retired from the firm on July 1, 1954. Thereafter, he gifted Rs. 75,000 to each of his four sons, three of whom were minors. There was a reconstitution of the firm with effect from July 2, 1954, whereby the major son became a partner and the minor sons were admitted to the benefits of partnership in the firm. The question was whether the income arising to the minors by virtue of their admission to the benefits of partnership in the firm could be included in the total income of the assessee under Section 16(3)(a)(iv), a provision similar to Section 16(3)(a)(iii). The Tribunal found that the capital invested by the minors in the firm came from the gifts made in their favour by their father, the assessee. The Supreme Court, while overruling the contention of the Revenue, came to the conclusion that the

connection between the gifts made by the assessee and the income of the minors from the firm was a remote one and that it could not be said that the income arose directly or indirectly from the assets transferred. They, therefore, held that the income arising to the three minor sons of the assessee by virtue of their admission to the benefits of partnership in the firm could not be included in the total income of the assessee. To our mind, it appears that the main reason why their Lordships of the Supreme Court so held in Prem Bhai's case was that, even though the minors received the gifts from their father on July 1, 1954, their admission to the benefits of the partnership on its reconstitution on July 2, 1954, depended on the volition and consent of the partners of the firm and did not flow merely from any right exercisable by the minors. That was why the income accruing to the minors on admission to the benefits of the partnership was remote and had no proximate connection with the transfer of the cash by their father to them. The income accrued neither directly nor indirectly inasmuch as such accrual of income depended upon the volition, consent or discretion of the partners of the firm either to admit these minors to the benefits of the partnership or not. It is in that context that the test of proximate or remote connection was laid down by the Supreme Court in Prem Bhai's case . This is clear from the following observations in the said judgment (p. 30) :

"The connection between the gifts mentioned earlier and the income in question is a remote one. The income of the minors arose as a result of their admission to the benefits of the partnership. It is true that they were admitted to the benefits of the partnership because of the contribution made by them. But there is no nexus between the transfer of the assets and the income in question. It cannot be said that that income arose directly or indirectly from the transfer of the assets referred to earlier. Section 16(3) of the Act created an artificial income. That Section must receive a strict construction as observed by this court in CIT v. Keskavlal Lallubhai Patel . In our judgment, before an income can "be held to come within the ambit of Section 16(3), it must be proved to have arisen--directly or indirectly--from a transfer of assets made by the assessee in favour of his wife or minor children. The connection between the transfer of assets and the income must be proximate. The income in question must arise as a result of the transfer and not in some manner connected with it."

12. We may also point out that the above said decision in CIT v. Prem Bhai Parekh was clearly distinguished by their Lordships of the Supreme Court in Mohini Thapar v. CIT , by holding that in Mohini Thapar's case , the income had a proximate connection with the transfer of the assets made by the assessee. It may be noted that in Mohini Thapar's case , cash was transferred by the assessee to his wife and the wife invested the same in deposits and shares, and the income from the deposits and shares were treated as having a proximate connection with the transfer of the cash by the assessee to his wife. The following observations in Mohini Thapar's case :

"Here we are dealing with an income which has a proximate connection with the transfer of the assets made by the assessee."

13. In other words, the Supreme Court held in Mohini Thapar's case that the transfer of the cash by the assessee to his wife was a "direct" transfer and that the income arising out of the deposits and shares purchased by her was an "indirect" income and that such income had a "proximate connection" with the transfer of the asset.

14. In the present case too, the position is identical with the position in Mohini Thapar's case as already stated. The assessee transferred Rs. 10,000 in favour of his wife in August 1967, the wife purchased 82 MICO shares with that money, sold the shares in March, 1973, for Rs. 36,516 and used the said consideration for the purchase of the house from her husband on March 5, 1973. The present is also a case where the income arising out of the house property is an indirect income arising out of a direct transfer of an asset by the husband in favour of his wife, one asset being substituted by another asset by the wife from time to time. The income arising from the asset, in our opinion, has a proximate connection with the transfer as in Mohini Thapar's case . The accrual of income was not remote as in Prem Bhai's case . For the aforesaid reasons, we are of the view that the provisions of Sub-clause (iv) of Section 64(1) are clearly attracted to the facts of the case and the annual letting value attributable to the entire Rs. 36,516 is to be included in the income of the assessee-husband.

15. Learned counsel for the assessee, Sri. Y. Ratnakar, has, however, placed reliance on another decision CIT v. Pelleti Sridevamma , rendered by a Division Bench of this court, already referred to, In that case, the assessee made a cash gift of Rs. 90,000 in the financial year 1956-57 to her minor son. This amount was utilised for purchasing a house property on behalf of the minor which was used by the assessee for the purpose of her business. After expiry of 8 years, i.e., in July, 1965, the property was sold for Rs. 1,48,000 by the assessee on behalf of the minor son and that resulted in a capital gain of Rs. 58,000. The dispute was whether this amount could be included in the hands of the assessee under Section 64(1)(iv) of the Income-tax Act, 1961. The Income-tax Officer as well as the Appellate Assistant Commissioner rejected the assessee's plea that it was not so includible, while the Tribunal held that there was no proximate connection between the cash gift and the capital gain and upheld the contention of the assessee. On a reference, the Division Bench of this court held, that in view of the time lag of 8 years between the date of the cash gift and subsequent sale of the house, it cannot be said that there was proximate relationship between the cash gift and the income arising from the sale of the house. The Division Bench distinguished Mohini Thapar's case and applied Prem Bhai's case . We have examined the facts of the case before the Division Bench in detail and we are of the view that, the said decision does not render any assistance to the assessee in the case before us. In the said case, the learned judges assumed that the time lag of 8 years between the date of the cash gift and subsequent sale of the house was an indication that there was no proximate relationship between the cash gift and the income arising from the sale of the house. We are of the view that the decision has to be treated as confined to the facts of that particular case and does not lay down any principle of universal application. In our view, the case before us is directly covered by the principle laid down by the Supreme Court in Mohini Thapar's case , the cash gift being direct, the income arising from the property purchased with the cash gift being indirect income and the relationship between the income and the cash gift being proximate.

16. For the aforesaid reasons, we disagree with the conclusion of the Tribunal, accept the contention of the Revenue and reject the contention advanced on behalf of the assessee. We answer the reference in the negative and hold that the annual letting value attributable to Rs. 36,516 is to be included in the income of the assessee and not merely the annual letting value proportionate to the sum of Rs. 10,000. In other words, we answer the reference in favour of the Revenue and against the assessee.