

HARISHIKESH GANGULI (DEAD)

v.

COMMISSIONER OF INCOME TAX, CALCUTTA

August 18, 1971

[K. S. HEGDE AND A. N. GROVER, JJ.]

Income-tax Act, 1922, s. 16(1)(c)—Settlor reserving benefit for himself under trust created by him—Trust whether becomes a revocable trust within meaning of section—Effect of third proviso.

The assessee derived income from house properties and from the business of a registered partnership firm. On March 19, 1953 the assessee created a trust in respect of two houses. It was provided in the trust deed that the trustees shall pay a sum of Rs. 200/- per month to the settlor, for life for his own absolute use and benefit out of the income of the trust estate remaining after payment of taxes, rents etc. The Income-tax Officer held that the income from the aforesaid two properties was assessable in the hands of the assessee inasmuch as he had retained a portion of the income from the trust properties for himself whereby the trust became a revocable trust under the provisions of s. 16(1)(c) of the Income-tax Act, 1922. The Appellate Assistant Commissioner upheld the view taken by the Income-tax Officer. The Tribunal however held that only the sum of Rs. 2400/- annually payable to the assessee could be taxed in his hands. In reference the High Court decided against the assessee. In appeal to this Court by special leave,

HELD : The effect of the third proviso to s. 16(1)(c) is that a settlement or disposition containing a provision for retransfer of a part of the income to the settlor would not render the whole income of the settlement chargeable in his hand provided the other conditions contained in the proviso are satisfied. In other words the proviso comes to the rescue of the settlor in that the portion of the income from the trust properties which are settled on a third person is to be assessed in the hands of that person and not in the hand of the settlor, if the latter does not retain any power to "deflect the same for a period exceeding six years or during the lifetime of the donee". Thus the settlement as a whole will not come within the mischief of s. 16(1)(c) if the revocability relates only to a part of the income. [314 H—315 B]

A significant change was made in the language with regard to revocable transfers in the Income-tax Act, 1961. Section 63(A) of that Act expressly refers to the whole or any part of the income or assets transferred. It can well be said that the necessity for expressly mentioning part of the income was felt because under the provisions of the 1922 Act part of the income was not covered. [315 C—F]

There was no dispute in the present case that the trust created was a genuine one. Since it fulfilled the conditions laid down in the third proviso only that part of the income which accrued or was received by the settlor could be assessed as his income. The income accruing to the other beneficiaries could not be included in the total income of the assessee.

[315 F]

C.I.T. Patna v. Rani Bhuvaneshwari Kuer, [1964]7 S.C.R. 920, applied.

Ramji Keshavji v. Commissioner of Income-tax, Bombay, 13 I.T.R. 105, referred to.

C.I.T. Calcutta v. Jitendranath Mallick, 50 I.T.R. 313, approved.

A CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1850 of 1967.

Appeal from the judgment and order dated September 30, 1966 of the Calcutta High Court in Income-tax Reference No. 102 of 1962.

B *M. N. Banerjee* and *P. K. Mukherjee*, for the appellants.
Jagdish Sarup, Solicitor-General, *R. N. Sachthey* and *B. D. Sharma*, for the respondent.

The Judgement of the Court was delivered by

C **Grover, J.** This is an appeal by special leave from a judgment of the Calcutta High Court answering the following question of law referred to it against the assessee and in favour of the Revenue :—

D “Whether on the facts and in the circumstances of the case, the entire or any part of the income from the house properties concerned could be included in the total income of the assessee by virtue of the provisions of s. 16(1)(c) of the Income tax Act, 1922 read with the first proviso thereto ?”

E The assessee was assessed in the status of an individual. He derived income from house properties and from the business of a registered partnership firm *H. Ganguly & Co.* He had six houses one of which was 24, Mohanlal Street, Calcutta and the other at Jangambari in the city of Banaras. On March 19, 1953 the assessee created a trust in respect of these two houses. It was provided in the trust deed that the trustees shall pay a sum of Rs. 200/- per month to the settlor for life for his own absolute use and benefit out of the income of the trust estate remaining after payment of taxes, rents etc. In other words he himself was one of the beneficiaries.

F
G The Income tax Officer held that the income from the aforesaid two properties was assessable in the hands of the assessee inasmuch as he had retained a portion of the income from the trust properties for himself. The trust had, therefore, become revocable under the provisions of s. 16(1)(c) of the Income tax Act 1922, hereinafter called the ‘Act’. The Appellate Assistant Commissioner on appeal affirmed the view taken by the Income tax Officer. When the matter came before the Appellate Tribunal it found that the assessee had irrevocably parted with the aforesaid two properties and the same had got vested in the trust. It was held that s. 16(1)(c) would become applicable only if the settlor reserved to himself the entire income arising from the settled properties; if only a portion had been reserved by the

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settlor it would not make the settlement revocable. It is not disputed that the total annual income from these properties came to over Rs. 19,000. Out of this the assessee, who was the settlor, was entitled to Rs. 2,400/- annually. According to the Tribunal only the amount of Rs. 2,400/- which had actually been received by the assessee under the terms of the trust deed could be included in his income.

The view of the High Court was that in order to be revocable under the first proviso to s. 16(1)(c) it is sufficient if the settlement, disposition or transfer contains a provision for retransfer of a part of the income to the settlor, disponent or transferor. It is not necessary that there must be a provision for the retransfer of the entire income. The word "income" includes any part of the income unless there is anything repugnant in the context. The High Court considered that the third proviso to s. 16(1)(c) did not explain the first proviso but was a kind of rider or exception to it. Bearing in mind the object behind the enactment of s. 16 and on a consideration of the terms of the section the true meaning and scope of the first proviso seemed to be that the settlement in the present case was revocable in its entirety thus attracting the substantive clause of s. 16(1)(c).

Clause (c) was introduced in s. 16(1) in the year 1939. At the material time s. 16(1) stood thus :—

"S. 16(1) In computing the total income of an assessee

(a)

(b)

(c) all income arising to any person by virtue of a settlement or disposition whether revocable or not, and whether effected before or after the commencement of the Indian Income tax (Amendment Act, 1939 from assets remaining the property of the settlor or disponent, shall be deemed to be income of the settlor or disponent and all income arising to any person by virtue of a revocable transfer of assets shall be deemed to be income of the transferor :

Provided that for the purposes of this clause a settlement, disposition or transfer shall be deemed to be revocable if it contains any provision for the retransfer directly or indirectly of the income or assets to the settlor, disponent or transferor, or in any way gives the settlor, disponent or transferor a right to reassume power directly or indirectly over income or assets;

(Grover, J.)

A Provided further that the expression 'settlement or disposition' shall for the purposes of this clause include any disposition, trust covenant, agreement or arrangement and the expression 'settlor or disponent' in relation to a settlement or disposition shall include any person by whom the settlement or disposition was made;

B Provided further that this clause shall not apply to any income arising to any person by virtue of a settlement or disposition which is not revocable for a period exceeding six years or during the life time of the person and from which income the settlor or disponent derives no direct or indirect benefit but that the settlor shall be liable to be assessed on the said income as and when the power to revoke arises to him."

C

D It is apparent that the above clause of s. 16(1) with its provisos is unhappily worded. In *Ramji Keshavji v. Commissioner of Income tax Bombay*(¹), the Bombay High Court considered the scheme of s. 16(1)(c). According to that decision the first stage is that when there is a revocable transfer of assets. The income derived from such assets is still to be considered the income of the settlor. The first proviso specifies what would be deemed a revocable transfer in spite of the deed being apparently irrevocable. The relevant question for the first proviso is "is this transfer revocable because it fulfils the conditions contained in the proviso?" The answer to that question can be in the positive or in the negative. If the answer is in the negative no further discussion can arise and s. 16(1)(c) will not be applicable. If the answer be in the affirmative the deed, although ostensibly irrevocable, is deemed to be revocable. It will thus become revocable within the meaning of the substantive provisions of s. 16(1)(c).

E Having reached that stage proviso (3) has to be considered. In the words of Kania J., as he then was "the scheme appears to be that although in fact, after reading the provision of s. 16(1)(c) with proviso (1), the transfer is revocable, the law will not still consider the income derived from such settlement, the income of the settlor, provided the settlement is not revocable for a period exceeding six years or during the lifetime of the person for whom the income is settled, and, further from which income the settlor derives no direct or indirect benefit." Chagla J., as he then was, delivered a separate judgment although he agreed with the answer given to the reference by Kania J. In his opinion the only way to reconcile the substantive provision of sub-cl. (c), provisos (1) and (3) was to hold that proviso (3) contained a limitation which applied as much to the substantive provisions of sub-clause (c) as to proviso (1).

The view expressed in the *Ramji Keshavji* case⁽¹⁾ was approved by this court in *C.I.T. Patna v. Rani Bhuvaneshwari Kuer*⁽²⁾. In that case the assessee, who owned an estate known as 'Tekari Raj', created a trust with a view to liquidate the debts of Tekari Raj. The beneficiaries under the deed were the settlor, her husband and her sons. It was declared that the settlement made was to be permanent and irrevocable but each beneficiary had full right to make any sort of arrangement about devolution or succession or make such alienation as was considered fit about his share. It was observed that two conditions were necessary for the application of the third proviso to section 16(1)(c), (1) that the trust should not be revocable for a period exceeding six years or during the life-time of the beneficiary and (2) the settlor or donor should have no direct or indirect benefit from the income given to the beneficiary. The following observations at page 927 are noteworthy :

"The third proviso to s. 16(1)(c) does not operate to exclude the income which the settlor receives as a beneficiary, from liability to income tax; it merely excludes that part of the income which is under the deed of settlement given to another person from liability to tax in the hands of the settlor, if the conditions prescribed by the third proviso are fulfilled. The contention raised by the Commissioner that if under the deed of trust the settlor has reserved to himself as a beneficiary any part of the income of the property settled, the third proviso will not apply to the deed of trust runs contrary to the plain words of the statute".

The further contention of the Commissioner that the third proviso only operated in respect of deeds of settlement or dispositions which were referred to in clause (c) but not the deeds of settlement or disposition which by the first proviso were deemed to be revocable was rejected by saying that the function of provisos (1) and (2) was plainly explanatory and it was impossible to hold that the third proviso did not operate in respect of settlement, dispositions or transfers which were by the first proviso revocable for the purposes of that clause.

We have referred to the above case in extenso because in our opinion it fully covers the point which has arisen in the present case.

In the light of the above principles it would not be wrong to say that the effect of the third proviso is that a settlement or disposition containing a provision for retransfer of a part of the income to the settlor would not render the whole income of the

A settlement chargeable in his hand provided the other conditions contained in the proviso are satisfied. In other words the proviso comes to the rescue of the settlor in that the portion of the income from the trust properties which are settled on a third person is to be assessed in the hands of that person and not in the hand of the settlor, if the latter does not retain any power to "deflect the same for a period exceeding six years or during the lifetime of the donee". Thus the settlement as a whole will not come within the mischief of s. 16(1)(c) if the revocability relates only to a part of the income. [See *C.I.T. Calcutta v. Jitendranath Mallick*(¹)]

B We are in entire agreement with the above view of the Calcutta High Court and consider that the same is supported by the decision of this court in *Rani Bhuvaneshwari Kuer's case*(²). We may also refer to the significant change made in the language with regard to revocable transfers in the Income tax Act 1961. Section 63 of that Act provides :

"For the purposes of section 60, 61 and 62 and of this Section—

- D (a) a transfer shall be deemed to be revocable if—
- (i) it contains any provision for the retransfer directly or indirectly of the whole or any part of the income or assets to the transferor, or
- E (ii) it, in any way, gives the transferor a right to reassume power directly or indirectly over the whole or any part of the income or assets :
- (b)

F It can well be said that the necessity for expressly mentioning part of the income was felt because under the provisions of the Act part of the income was not covered. There is no dispute in the present case that the trust created was a genuine one. Since it fulfilled the conditions laid down in the third proviso only that part of the income which accrued or was received by the settlor could be assessed as his income. The income accruing to the other beneficiaries could not be included in the total income of the assessee.

G The appeal is consequently allowed and the judgment of the High Court is set aside. The question which was referred shall stand answered in favour of the assessee and against the Revenue. In view of the nature of the points involved the parties shall bear their own costs.