A

COMMISSIONER OF INCOME TAX

v.

SMT. PELLETI SRIDERAMMA, NELLORE

OCTOBER 11, 1995

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[B.P. JEEVAN REDDY AND S.B. MAJMUDAR, JJ.]

Income Tax Act, 1961 :

Section 2(24)—'Income'—Includes 'Capital Gains'.

C

Section 64(1)(iv)—Assessee—Cash gift to minor son—Money utilised to purchase property—Property utilised for assessee's business—Sale of property after eight years—Capital gains—Held liable to be included in assessee's income.

D

Income Tax—Clubbing of—Assessee—Income arising from assets transferred to minor—Proximity—Relevance of—Held proximity should be between assets transferred and the income in question—Time lag is of no significance.

The respondent-assessee, carrying on mica mining business, made a cash gift of rupees ninety thousand to her minor son during the financial

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year 1956-57. Immediately thereafter the said amount was ultilised for purchasing a house property which was utilised for the purpose of assessee's business. After eight years when the said property was sold the capital gain of Rs. 58,000 was included in the assessee's income in terms of Section 64(1)(iv) of the Income Tax Act, 1961. Assessee's appeal was dismissed by Appellate Assistant Commissioner while the Tribunal al-

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lowed her second appeal relying upon the decision in *Commissioner of Income Tax* **v.** *Prem Bhai Parekh & Ors.*, **(1970) 77 ITR 27. The High Court too relying on the aforesaid case held in favour of the assessee on the ground that in view of the time lag of eight years between the cash gift and the subsequent sale of the house property there was no proximate relation-**

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ship between the cash gift and the income arising from the sale of the house.

Allowing Revenue's appeal and setting aside the judgment of the High Court, this Court

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HELD : 1. Clause (iv) of Section 64 (1) of the Income Tax Act, 1961

provided that in computing the total income of an individual there shall be included all such income as arises directly or indirectly to a minor child (not being a married daughter of such individual) from assets transferred directly or indirectly to the minor child by such individual otherwise than for adequate consideration. The facts of this case squarely fall within the said rule. It is true that what was gifted by the assessee to her minor son was the cash of Rupees ninety thousand but that money was utilised for purchasing the house property. It was only a case of substitution of one form of property by another form of property. When the said house property was sold, a capital gain of Rupees fifty eight thousand was made. Capital gain is undoubtedly a type of income. The definition of 'income' in Section 2(24) includes "capital gains". It was, therefore, liable to be included in the income of the assessee. [209-D-F]

2. The expression "proximate" occurring in *Prem Bhai Parekh* **case was understood by the High Court as proximity in point of time. It is not a correct understanding of the ratio of the said judgment. The proximity referred to by this Court was not proximity in point of time but proximity between the transfer of assets and the income in question. Therefore, the time lag, if any, is of no significance under Section 64 (1) (iv). [213-C-D]**

Commissioner of Income Tax, West Bengal-III **v.** *Prem Bhai Parekh & Ors.*, **(1970) 77 ITR 27, explained and held inapplicable.**

Savantilal Maneklal Sheth **v.** *CIT (Central) Bombay*, **(1968) 68 ITR 503,** *Smt. Mohini Thapar* **v.** *Commissioner of Income Tax (Central), Calcutta & Ors.*, **(1972) 83 ITR 208 and** *CIT* **v.** *V.J. Aleykutti*, **(1991) 189 ITR 711, referred to.**

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1053 of 1977

From the Judgment and Order dated 6.4.76 of the Andhra Pradesh High Court in R.C. No. 38 of 1973.

J. Ramamurthy and R. Sathish for the Appellant.

The Judgment of the Court was delivered by

B.P. JEEVAN REDDY, J. This appeal is preferred against the judgment of the Andhra Pradesh High Court answering the question referred

A to it in the negative, i.e., against the Revenue and in favour of the assessee. The question referred is "whether on the facts and in the circumstances of the case, the capital gain of Rs. 58,000 was assessable in the hands of the assessee in terms of Section 64(1)(iv) of the Income Tax Act, 1961." The assessment year concerned herein is 1966-67. Section 64(1)(iv), as it stood at the relevant time, read thus :

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> "64 (1). In computing the total income of any individual, there shall be included all such income as arises directly or indirectly :
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> (iv) subject to the provisions of clause (i) of Section 27, to a minor child, not being a married daughter of such individual, from assets transferred directly or indirectly to the minor child by such individual otherwise than for adequate consideration."

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Reference to clause (i) of Section 27 is not necessary since it has no relevance to the facts of this case.

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The respondent-assessee is an individual. She was carrying on the business of mica mining and was also having income from property and money lending. During the financial year 1956-57, the respondent made a cash gift of Rupees ninety thousand to her minor son, Suryanarayana Reddy. This amount was immediately utilised for purchasing a house

E property at Gudur. The said house property was being utilised for the propose of the assessee's business. Eight years after the purchase of the house, i.e., on July 5, 1967, the said house property was sold to Tirupati Devasthanam for a consideration of Rs. 1,48,000. On the date of this sale also, Suryanarayana Reddy was a minor. The Income Tax Officer included

F the capital gain of Rs. 58,000 in the assessee's income in terms of Section 64(1), which was objected to by the assessee. Her appeal to the Appellate Assistant Commissioner was dismissed. Her second appeal was, however, allowed by the Tribunal relying mainly upon the decision of this Court in *Commissioner of Income Tax, West Bengal-III* v. *Prem Bhai Parekh & Ors.*,

G (1970) 77 I.T.R. 27. Thereupon, the said question was referred for the opinion of the High Court at the instance of the Revenue. The High Court too held in favour of the assessee, again relying mainly upon the decision in *Prem Bhai Parekh*.

Sri J. Ramamurthy, learned counsel for the Revenue, submits that

H the High Court has misunderstood the ratio of *Prem Bhai Parekh*. He

submits that the ratio of the said decision has no application herein. On the contrary, the learned counsel submits, the facts of *Sevantilal Maneklal Sheth* v. *Commissioner of Income Tax (Central), Bombay*, (1968) 68 I.T.R. 503 are quite similar to the facts of this case and that the ratio of the said decision squarely governs it and concludes the issue in favour of the Revenue. Learned counsel also pointed out that the decision in *Prem Bhai Parekh* was explained and distinguished by this Court in *Smt. Mohini Thapar* v. *Commissioner of Income Tax (Central), Calcutta & Ors.*, (1972) 83 I.T.R. 208. Counsel submits that though both these decisions were brought to the notice of the High Court, it has erred in distinguishing these two decisions and in following *Prem Bhai Parekh*. We are inclined to agree with Sri Ramamurthy.

Let us first see what does clause (iv) of Section 64(1) say. In computing the total income of an individual, it says, there shall be included all such income as arises directly or indirectly to a minor child (not being a married daughter of such individual) from assets transferred directly or indirectly to the minor child by such individual otherwise than for adequate consideration. The facts of this case squarely fall within the said rule. The respondent-assessee made a gift of Rupees ninety thousand to her minor son, Suryanarayana Reddy. The said money was utilised immediately for purchasing a house property. As a matter of fact, the said house property was also being utilised for the purpose of assessee's business until it was sold eight years later. Even at the time of the said sale, Suryanarayana Reddy was a minor. It is true that what was gifted by the assessee to her minor son was the cash of Rupees ninety thousand but it cannot be forgotten that that money was utilised for purchasing the said house property. It was only a case of substitution of one form of property by another form of property. When the said house property was sold, a capital gain of Rupees fifty eight thousand was made. Capital gain is undoubtedly a type of income. The definition of "income" in Section 2(24) includes "capital gains". It was, therefore, liable to be included in the income of the assessee.

In *Sevantilal Maneklal Sheth*, the facts were the following : in the year 1951, the assessee, Maneklal, gifted 1,184 ordinary and 155 preference shares of a particular sugar mills to his wife, Bai Laxmibai. On the date of transfer, their total value was Rs. 69,730. Subsequent to the said gift, the sugar mills converted the preference shares into ordinary shares giving

A eight ordinary shares for each preference share, with the result that on December 31,1954 Bai Laxmibai held a total of 2,424 ordinary shares of the said sugar mills. Out of those 2,424 ordinary shares, Bai Laxmibai sold 2,400 shares on August 1,1956 for a sum of Rs. 1,54,800, resulting in a capital gain of Rs. 70,860, as computed under Section 12-B of the Indian Income Tax Act, 1922. The whole amount so realised was deposited by Bai B Laxmibai in a particular firm in which her husband, Maneklal, as well as her son, Sevantilal, were partners. The said deposit earned yearly interest of Rs. 9,288. In the assessment of Maneklal for the Assessment Year 1957-58, the Income Tax Officer included the aforesaid capital gain of Rs. 70,860 under Section 16(3)(a)(iii) of the Indian Income Tax Act (which C corresponds to Section 64(1)(iv) concerned herein). Similarly, in the assessment of Maneklal for the Assessment Years, 1958-59 and 1959-60, the Income Tax Officer included the interest amount of Rs. 9,288, again applying the said provision. This was objected to by the assessee. The matter was ultimately carried to this Court. The following observations in D the judgment are relevant :

> "In our opinion, there is no logical distinction between income arising from the asset transferred to the wife and arising from the sale of the assets so transferred. The profits or gains which arise from the sale of the asset would arise or spring from the asset, E although the operation by which the profits or gains is made to arise out of the asset is the operation of the sale...... There is hence no warrant for the argument that the capital gain is not income arising from the assets, but it is income, which arises from a source which is different from the asset itself...... The object of the F enactment of the section is to prevent avoidance of tax or reducing the incidence of tax on the part of the assessee by transfer of his assets to his wife or minor child. It is a sound rule of interpretation that a statute should be so construed as to prevent the mischief and to advance the remedy according to the true intention of the makers of the statute."

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Now, let us see the facts and ratio of *Prem Bhai Parekh*. The assessee was a partner in a firm having seven annas share therein. He retired from the firm on July 1, 1954. Thereafter, he gifted Rupees seventy five thousand to each of his four sons, three of whom were minors. There was a H reconstitution of the firm with effect from July 2, 1954 whereunder the

major son became a partner and the three minor sons were admitted to the benefits of partnership. It is on these facts that the question arose whether the income accruing to the minors by virtue of their admission to the benefits of partnership could be included in the total income of the assessee under Section 16(3)(a)(iv). The said provision read thus at the relevant time: "In computing the total income of any individual for the purpose of assessment, there shall be included-(a) so much of the income of a wife or minor child of such individual as arises directly or indirectly..... (iv) from assets transferred directly or indirectly to the minor child, not being a married daughter, by such individual otherwise than for adequate consideration." The question that required to be answered by this Court was : "whether it can be said that the income with which we are concerned in this case arises directly or indirectly from the assets transferred by the assessee to those minors". The Court answered it in the negative, in the following words :

> "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 strict construction as observed by this court in *Commissioner of Income-Tax* v. *Keshavlal Lallubhai Patel*, (1965) 55. I.T.R. 637 S.C. 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."

It would immediately be seen that the income that arose to the minors arose on account of their being admitted to the benefits of partnership firm and not from the assets transferred by the assessee to them. As pointed out by this Court, it is true that they were admitted to the benefits

A of partnership because of their contribution of the said capital but the income received by them was not directly relatable to or proportionate to the said investment. The income of the partnership arises from its business. It may be a loss or it may be extraordinary profits; it may also be a case of no profit at all. The loss or profit of the firm depends upon the nature and B circumstances of the business carried on by it. It is in this connection that this Court held that the connection between the transfer of assets and the income received was a remote one and not proximate. The proximity referred to by this Court was not proximity in point of time but proximity between the transfer of assets and the income in question. This Court repeatedly pointed out that the income derived by the minors was the result C of their admission to the benefits of partnership and that the connection, if any, between their investment and the income derived by them was remote and not proximate.

Indeed, it is in this manner that this decision was understood and D distinguished in the subsequent decision of this Court in *Smt. Mohini Thapar*. (It would be relevant to note that the decision in *Prem Bhai Parekh* and the decision in *Smt. Mohini Thapar* were both delivered by K.S. Hegde, J.). We may not the facts in *Smt. Mohini Thapar.* The assessee made certain cash gifts to his wife. From out of those cash gifts, she purchased shares and invested the balance amount in deposits. The question was whether E the income derived by the assessee's wife from the deposits and shares is liable to be included in the income of the assessee-husband under Section 16(3) of the Indian Income Tax Act, 1922. Hedge, J. observed, "(T)he assets transferred in this case is the gift of the cash amounts made by the assessee to his wife. The transfers in question are direct transfers. But those F assets, as mentioned earlier, were invested either in shares or otherwise. Hence it was urged on behalf of the revenue that the incomes realised either as dividends from shares or as interest from deposits are income indirectly received in respect of the transfer of cash directly made. This contention of the revenue appears to be sound. That position clearly G emerges from the plain language of the section." When the learned counsel for the assessee relied upon the decision in *Prem Bhai Parekh* in support of his contention that there was no nexus between the income earned and the transfer of assets, it was repelled holding that in *Prem Bhai Parekh*, "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 H the income arose directly or indirectly from the assets transferred". It was

pointed out that it is for this reason, it was held in that case that the income of the minors cannot be included in the total income of the assessee. Hedge, J. then quoted the very same paragraph from *Prem Bhai Parekh* which we have quoted hereinabove and held that the said decision has no application to the facts in *Smt. Mohini Thapar.*

Now, coming to the judgment under appeal, the main basis upon which the High Court held in favour of the assessee is the time lag of eight years between the date of cash gift and the subsequent sale of the house property. Because of the said time lag, it was held that there was no proximate relationship between the cash gift and the income arising from the sale of the house. In other words, the expression "proximate" occurring in *Prem Bhai Parekh* was understood as proximity in point of time which, in our respectful opinion, is not a correct understanding of the ratio of the said judgment. The proximity referred to in *Prem Bhai Parekh*, as already pointed out hereinabove, is the proximity between the assets transferred and the income in question. The time lag, if any, is of no significance under Section 64(1)(iv).

It is brought to our notice that a Bench of the Kerala High Court in *Commissioner of Income Tax* v. *V.J. Aleykutti*, (1991) 189 I.T.R. 711, *K.S. Paripoornan and Jagannadha Raju, JJ.* has distinguished the decision in *Prem Bhai Parekh* on these very lines.

Before parting with this case, we may mention that when this appeal came up for hearing, it was stated by Sri T.A. Ramachandran, learned counsel, that the Advocate-on-Record for the respondent, Smt. Janki Ramachandran, has been instructed by the client not to oppose the appeal and for that reason, she would not be participating in the hearing of the appeal. The said statement was recorded by us in the proceeding dated September 29, 1995.

For the above reasons, the appeal is allowed, the judgment of the High Court is set aside and the question referred under Section 256 is answered in the affirmative, i.e., in favour of the Revenue and against the assessee. No costs.

T.N.A. Appeal allowed.