IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 21.12.2020

CORAM

THE HON'BLE DR.JUSTICE VINEET KOTHARI
AND
THE HON'BLE MR.JUSTICE M.S.RAMESH

Tax Case No.2604 of 2006

Tmt.T.A.H.Zubaida Ummal — Appellant

Vs.

The Income Tax Officer,
Ward-I(1), Nagapattinam. — Respondent

Tax Case filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, 'B' Bench, Chennai, dated 16.12.2005 made in ITA No/660/Mds/2002.

For Appellant : Mr.R.Parthasarathy

For Respondent : Mr.M.Swaminathan,
Senior Standing Counsel assisted by
Ms.V.Pushpa, Jr.Standing Counsel

JUDGMENT
(Delivered by DR.VINEET KOTHARI,J)

Heard Mr.R.Parthasarathy, learned counsel appearing for the Appellants/Assessee and Mr.M.Swaminathan, learned Senior Standing Counsel appearing for the Respondent/Revenue.

2. The Tax Case has been admitted on 23.6.2008 on the following questions of law:-

"i) Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in not appreciating that no part of the consideration for sale was received by the appellant and same was directly paid to the Bank by the purchaser in discharge of the mortgage amount and therefore no capital gains arises in the hands of the appellant?

ii) 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 towards redeeming the interest of the mortgagor and therefore the amount so diverted was not liable to capital gains tax?"

3. The relevant portion of the order passed by the learned Tribunal is extracted below for ready reference:-

"3. It is to be noted that on identical facts in the same group of Assessees, coordinating bench,

has considered similar issue and decided the issue against the Assessee. The relevant paragraph 4 is reproduced as it is:

4. We have perused the grounds of appeal and the records available before us. We have also heard the learned counsel for the assessee and considered his submissions. It is not disputed that the assessee never incurred the expenditure wholly and exclusively in connection with such transfer. No doubt it has wider connotation than the expression for the transfer. In the decision of the Hon'ble jurisdictional High Court in the case of CIT vs. N.Vajrapani Naidu, 241 HR 560 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 consideration to the sale. Hence the assessee's claim was held to be rightly rejected by the Income-tax Officer. Section 48 of the Income-tax

Act clearly lays down the condition that to compute capital gain the expenditure must be incurred wholly and exclusively in connection with such transfer and cost of acquisition of the asset and the cost of improvement thereto. These are the expenses available for deduction while computing capital gains. Here in this case the sale consideration was paid directly to the company M/s.M.O.H.(P) Ltd. towards the loan from the bank. It is hit by section 48 of the Act as it is not an allowable deduction under section 48. Therefore the claim of the assessee that there is no capital gain since the assessee has not received any consideration, is to be brushed aside. The decision of the Hon'ble Supreme Court in the case of RM.Arunachalam vs. CIT, 227 ITR 222 is directly on the point at issue. However, the learned counsel for the assessee attempted to impress us that according to the aforesaid decision of the Hon'ble Supreme Court at page 225 the payment for the purpose of acquiring the

interest of the mortgagee in the property by the heir was held to be regarded as cost of acquisition under section 48 read with section 55(2) of the Act. But in this case there is no liability attached to the succession. The assessee purchased the property without any encumbrance and the subsequent encumbrance created as a guarantee to the company M/s.M.O.H.(P) Ltd., has nothing to do and it cannot be deducted as it never comes within the allowable deduction under section 48 of the Act. Respectfully following the decisions of the Hon'ble Supreme Court and the jurisdictional High Court we set aside the order of the Commissioner (Appeals) and confirm the order of the Assessing Officer."

4. Both the learned counsels submitted that the controversy involved in the present Tax Case is covered by the Judgement rendered by a Division Bench of this Court in ***Tmt.D.Zeenath v. Income-tax Officer, Ward-I(1) Nagapattinam,*** in which one of us (Dr.Justice Vineet Kothari) was a party, wherein the Court has held as under:-

*"**29.** In our opinion, the ratio in R.M.Arunachalam (supra), squarely applies to this case. As held by the Hon'ble Supreme Court, 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 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.*

***30.** This position had been reiterated by the Hon'ble Supreme Court in, V.S.M.R. Jagadishchandran (supra). The facts in that case were as follows. The facts and the judgment of the Hon'ble Supreme Court are extracted below:*

'This appeal by the assessee is directed

against the order dt. 25th July, 1984 passed by the Madras High Court in TC No. 145 of 1983 wherein the High Court on an application filed under s. 256(2) of the Act declined to direct the Tribunal to state a case and refer the following questions of law to the High Court :

"1. Whether the Tribunal was right in holding that the levy of the capital gains of Rs. 68,400 is proper under the facts and circumstances of the case ?

2. Whether the Tribunal was right in holding that mortgage debts does not constitute diversion at source?

3. Whether the debts discharged by the applicant on the properties cannot be said to enhance the cost of acquisition."

The assessee sold a house property No. 22, Chairman Muthurama Iyer Road, Madurai for a sum of Rs.90,000 subject to incumbrance in the assessment year 1975-76 and for the

same assessment year he sold plot Nos.1, 3 and half of plot No.4 in T.S. No.831/1 for a sum of Rs.12,600. The Income-Tax Officer computed the capital gains in respect of the said properties at Rs.68,400. The assessee questioned the computation of capital gains before the Appellate Assistant Commissioner and contended that the debts in respect of which mortgage had been executed were discharged by the buyer himself out of the sale proceeds, that the debts should be considered as increase in cost of acquisition of the properties and that in any event the debts may be treated as improvement to the property or as the cost of obtaining clear title to the property. The Appellate Assistant Commissioner rejected the said contention. He, however, upheld the contention of the assessee that there was an overriding title of the creditors in respect of the sale proceeds and, therefore, there was diversion at source

on the basis of such overriding title and the assessee was not liable to charge under the capital gains in respect of the sale of the properties and, therefore, he deleted the capitals gains of Rs.68,400 as computed by the ITO. The Tribunal, following the decision of the Kerala High Court in Ambat Echukutty Menon v. CIT (1(1978) 111 ITR 880 (Ker), and the decision of the Madras High Court in CIT v. V.Indira (1979) 119 ITR 837 (Mad) held that clearing of the mortgage debt could neither be treated as "cost of acquisition" nor as an "cost of improvement" made by the assessee. The Tribunal, therefore, held that the deduction of the capital gains was not justified. Since the Tribunal declined to refer to the High Court the questions referred to above, the assessee filed an application under s.256(2) of the Act before the High Court which has been rejected by the impugned order. The High Court has relied upon the

decision of the Full Bench of the High Court in S. Valliammai & Anr. v. CIT (1981) 127 ITR 713 (Mad) and has held that by discharging the mortgage debt subsisting on the property which was the subject-matter of a sale, the assessee was not either improving or perfecting his title or improving the property in any manner and, therefore, the amount paid for discharging the mortgage debt cannot be taken to be for the cost of acquisition as contended by the assessee.

In Civil Appeals Nos.6098-6101 of 1983 [since reported as R. M. Arunachalam etc. v. CIT (1997) 141 CTR (SC) 348 filed against the judgment of the Full Bench of the Madras High Court in S. Valliammai & Anr. v. CIT (supra) we have examined the correctness of the view of the Kerala High Court in Ambat Echukutty Menon v. CIT (supra) and have held that the said decision does not lay down the correct law in so far as it holds that where the

previous owner had mortgaged the property during his life time the clearing off the mortgage debt by his successor can neither be treated as cost of acquisition nor as cost of improvement made by the assessee. It has been held that where a mortgage was created by the previous owner during his time and the same was subsisting on the date of his death, the successor obtains only the mortgagors interest in the property and by discharging the mortgage debt he acquires the mortgagees interest in the property and, therefore, the amount paid to clear off the mortgage is the cost of acquisition of the mortgagees interest in the property which is deductible as cost of acquisition under s. 48 of the Act. In the present case, we find that the mortgage was created by the assessee himself. It is not a case where the property had been mortgaged by the previous owner and the assessee had acquired only the mortgagors interest in the

property mortgaged and by clearing the same he had acquired the interest of the mortgagee in the said property. The questions raised by the assessee in the application submitted under s. 256(2) of the Act do not, therefore, raise any arguable question of law and the said application was rightly rejected by the High Court. In the circumstances, even though we are unable to agree with the reasons given in the impugned order, we are in agreement with the order of the High Court dismissing the application filed by the assessee under s.256(2) of the Act.

The appeal is, therefore, dismissed. No order as to costs.'

31. *It is thus seen that the Hon'ble Supreme Court had held that where the mortgage had been created by the owner after he had acquired the property, the clearing of the mortgage by him prior to the 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."

5. The Assessee in the said case is a co-owner of the present Appellant/Assessee. Therefore, the present Tax Case is disposed of in same terms and the questions of law are answered against the Assessee and in favour of the Revenue. No costs.

(V.K.,J.) (M.S.R.,J.)
21.12.2020

Index : No
Internet : Yes/No
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To

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DR.VINEET KOTHARI, J.
and
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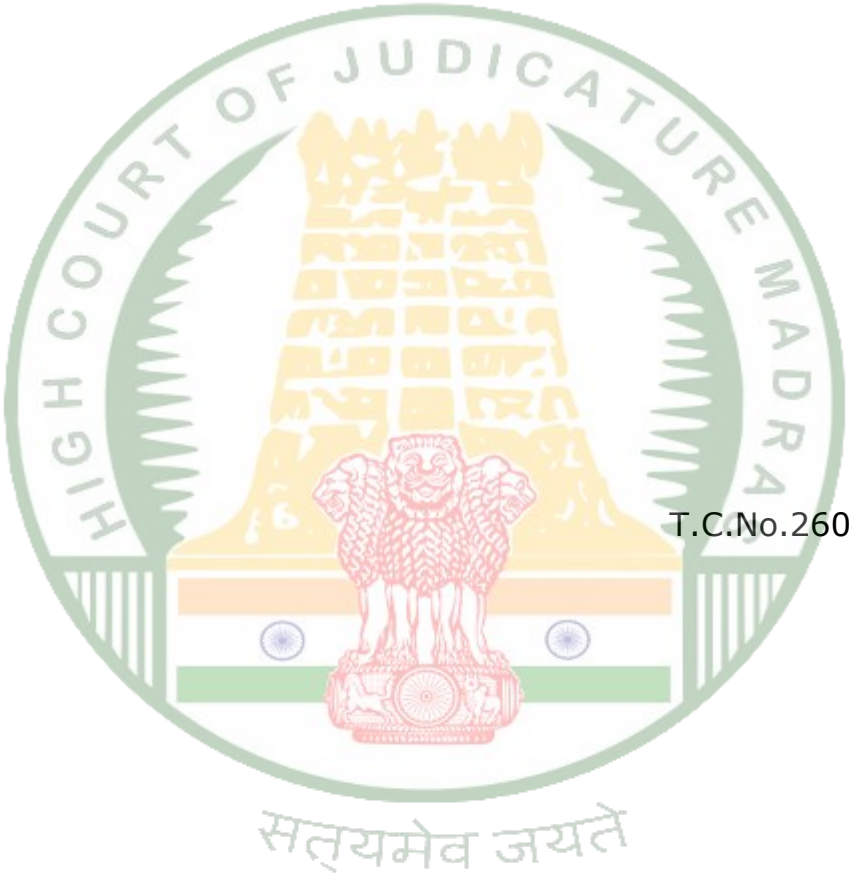

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