

Kerala High Court

Ambat Echukutty Menon vs Commissioner Of Income-Tax, ... on 22 June, 1977

Equivalent citations: 1978 111 ITR 880 Ker

JUDGMENT BALAKRISHNA ERADI J. - The Income-tax Appellate Tribunal, Cochine Bench, has referred to this court under section 256(1) of the Income-tax Act, 1961, hereinafter called the Act, the following questions of law :

"(i) Whether, on the facts and circumstances of the case, the sum of Rs. 58 643 spent by the assessee did not represent the cost of acquisition of the capital asset within the meaning of section 48 read with section 55(2) of the Income-tax Act, 1961 ?

(ii) Whether, on the facts and circumstances of the case, the Tribunal was right in holding that the sum of Rs. 58,643 spent by the assessee did not represent the cost of improvement within the meaning of section 48 read with section 55(1)(b) of the Income-tax Act, 1961 ?

(iii) Whether, on the facts and circumstances of the case, the Tribunal was right in finding that the assessee cannot get a deduction under section 48(ii) of the Income-tax Act, 1961, of anything more than Rs. 58,643 ?"

The relevant facts which have given rise to the aforesaid questions fall within a short compass. One Shri A. Padmanabha Menon purchased an item of immovable property for Rs. 48,500 on December 10, 1953. He had to incur an additional expenditure of Rs. 1,420 by way of stamp duty and registration expenses in respect of that transaction of sale. Padmanabha Menon died in 1957. Before his death, he had hypothecated the property and it was only subject to the said mortgage that the property devolved on his heirs. The assessee has inherited a 1/5th share in the property. The assessee along with his other co-heirs discharged the mortgage created by the deceased, Padmanabha Menon, by payment of Rs. 58,643 to the mortgagee. Subsequently, the property was acquired by the State Government under the Land Acquisition Act on January 8, 1971, and a total compensation of Rs. 3,39,473 was paid to the assessee and the other four co-owners.

In respect of the 1/5th share of the property belonging to the assessee, he declared a capital gain of Rs. 16,925. The mode of computation of income chargeable under the head capital gains adopted by the assessee was to deduct from the compensation received from the Government, the expenses incurred in the purchase of the property inclusive of stamp duty, etc., amounting in all to Rs. 49,920 and also the further sum of Rs. 58,643 spent by the assessee and his co-heirs for clearing off the encumbrance created by the deceased, Padmanabha Menon. The assessee had also purported to make some other deductions, but subsequently he gave up the claim in respect of them and hence it is unnecessary to deal with them here. The Income-tax Officer proceeded on the basis that the capital asset became the property of the assessee after January 1, 1954, by virtue of succession to the previous owner who died in 1957, and he treated the cost of acquisition as Rs. 58,643 which was the amount paid by the assessee and the co-heirs for clearing off the encumbrance. By adopting the said method of the Income-tax Officer held that the 1/5th share of the income chargeable to capital gains at the hands of the assessee was Rs. 30,341 and the assessment was accordingly completed. An appeal was filed by the assessee before the Appellate Assistant Commissioner of Income-tax,

Trichur, contending that the amount of Rs. 58,643 expended on discharging the mortgage ought to have been treated as the cost incurred by the assessee in effecting an improvement to the capital asset and that hence a deduction ought to have been allowed in respect of the said amount in addition to the actual cost incurred by the previous owner for the purchase of the property, namely, Rs. 49,920. This contention was rejected by the Appellate Assistant Commissioner who confirmed the assessment made by the Income-tax Officer. On the matter being carried by the assessee in second appeal before the Income-tax Appellate Tribunal, the Tribunal agreed with the view taken by the Appellate Assistant Commissioner that the amount spent by the assessee in clearing off the encumbrance created by the previous owner could not be treated as cost of improvements. The assessee had put forward an alternative contention before the Tribunal that since the property had devolved on the assessee by inheritance only subject to the burden of the mortgage the amount expended by the assessee for clearing off the said mortgage and for perfecting the title to the property must also be treated as part of the cost of acquisition. This contention was rejected by the Tribunal on the ground that in cases where a capital asset which has been acquired by the previous owner before the 1st day of January, 1954, becomes the property of the assessee by one of the modes specified in sub-section (1) of section 49, only the cost for which the previous owner had acquired the capital asset or the fair market value of the asset on the 1st day of January, 1954, at the option of the assessee, is to be regarded as "cost of acquisition". Inasmuch as the Income-tax Officer had already allowed a deduction in respect of Rs. 58,643, the Tribunal held that the assessee was not entitled to have the cost of acquisition fixed at any higher figure and the appeal was accordingly dismissed. Thereafter, at the instance of the assessee, the Tribunal has drawn up a statement of the case and referred the aforementioned questions to this court.

Section 45 of the Act lays down that any profits or gains arising from the transfer of a capital assets effected in the previous year shall, except as otherwise provided in sections 53, 54, 54B, 54C and 54D, be chargeable to income-tax under the head "capital gains", and shall be deemed to be the income of the previous year in which the transfer took place. Section 48 deals with the mode of computation of the income chargeable under the head "Capital gains" and it states that the computation shall be made by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely : (i) expenditure incurred wholly and exclusively in connection with such transfer, and (ii) the cost of acquisition of the capital asset and the cost of any improvement thereto. We shall next refer to section 49 which has a direct bearing on the question now under consideration. That section, direct bearing on the question now under consideration. That section, omitting such provisions as are not relevant for the present purpose, reads :

"49. (1) Where the capital asset became the property of the assessee -

(iii) (a) by succession, inheritance or devolution, or.....

the cost of acquisition of the assets shall be deemed to be the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be."

The only other section that need to be referred to is section 55 which supplies the meaning of the expressions "cost of improvement" and "cost of acquisition". Section 55(1)(b)(i) provides that where the capital asset became the property of the previous owner or the assessee before the 1st day of January, 1954, and the fair market value of the asset on that day is taken as the cost of acquisition at the option of the assessee, the expression "cost of improvement" in relation to such capital asset shall mean all expenditure of a capital nature incurred in making any additions or alterations to the capital asset on or after the said date by the previous owner or the assessee. Sub-section (2)(ii) of the said section states that in relation to a capital asset where the capital asset became the property of the assessee by any of the modes specified in sub-section (1) of section 49, and it had become the property of the previous owner before the 1st day of January, 1954, the expression "cost of acquisition" means the cost of the capital asset to the previous owner or means the fair market value of the asset on the 1st day of January, 1954, at the option of the assessee.

In the case before us the capital asset had become the property of the assessee by succession or inheritance on the death of the previous owner, namely, Shri Padmanabha Menon, who had acquired the property in December, 1953. Such being the position, under section 49(1)(iii) the cost of acquisition of the asset is to be deemed to be the cost for which the previous owner of the property, namely, Shri Padmanabha Menon, acquired it, as increased by the cost of any improvement of the assets incurred or borne either by the previous owner or by the assessee. It is not disputed that the cost for which the previous owner acquired the property was only Rs. 49,920. The only further question to be considered is whether any improvement can be said to have been effected in respect of the capital asset that was purchased either by the previous owner or by the assessee so as to entitle the assessee to claim a deduction under the head "Cost of improvements". Having regard to the definition contained in clause (b) of sub-section (1) of section 55 it appears to us to be clear that in order to entitle the assessee in this case to claim a deduction in respect of the cost of any improvement, the expenditure should have been incurred in making any additions or alterations to the capital asset that was originally purchased by the previous owner. If subsequent to the purchase of the property by the previous owner it was mortgaged by him and that mortgage was later discharged either by himself or by his successor-in-interest, that would not constitute an improvement to the capital asset which originally became the property of the previous owner. In the present case, when Padmanabha Menon purchased the property it was free from any encumbrance. It was he who created an encumbrance by way of mortgage after the capital asset had become his property. When the assessee and his co-owners cleared off that mortgage it cannot be said that they have incurred any expenditure by way of cost of effecting any improvement to the capital asset that was originally purchased by the previous owner. The Tribunal was, therefore, perfectly right in holding that the assessee is not entitled to claim any deduction in respect of the expenditure of Rs. 58,643 incurred by the assessee in paying off the encumbrance created by the previous owner.

In the light of the foregoing discussion, our answer to question No. 1, is that the Tribunal was right in holding that the sum of Rs. 58,643 spent by the assessee did not represent the cost of acquisition of the capital asset within the meaning of section 48 read with section 55(2) of the Act. We also hold on questions Nos. 2 and 3 that the Tribunal was right in holding that the sum of Rs. 58,643 spent by the assessee did not represent the cost of improvement within the meaning of section 48 read with section 55(1) (b) of the Act and that the assessee was not entitled to get a deduction of anything

more than what was already allowed by the Income-tax Officer. All the questions are thus answered against the assessee and in favour of the department. We direct the parties to bear their respective costs.