

Commissioner of Income-Tax, Bihar and Orissa

Vs

Rani Bhuwaneshwari Kuer

Civil Appeal No. 620 of 1963

(J. C. Shah, S. M. Sikri, K. Subha Rao JJ)

28.04.1964

JUDGMENT

SHAH J. -

Rani Bhuwaneshwari Kuer - hereinafter referred to as "the assessee" - was the proprietor of a seven - sixteenth share in an estate known as "Tekari Raj", having inherited that estate from her parents. The assessee later acquired by purchase a major portion of the remaining nine-sixteenth share in the Raj. The estate held by the assessee was heavily encumbered, and with a view to arrange for liquidation of the debts the assessee executed an indenture of trust dated January 20, 1941, whereby the Tekari Raj and certain zamindari properties owned by the assessee were conveyed to certain named trustees to be held in trust, subject to conditions specified therein. The principal beneficiaries under the deed after payment of the debts were the assessee, her husband and her five sons.

By the 23rd clause of the deed it was directed that after making certain payments, the trustees shall divide the surplus of the net rents, issues and profits thereof in the proportions set out in the clause. The 24th and the 25th clauses dealt with the devolution of the beneficial interest in the event of death of any of the beneficiaries. By the 41st clause it was provided that after the debts and liabilities set out in Schedule "D" to the deed were paid off and discharged, the settlor shall be entitled to make a permanent trust of some of the villages demised under the deed for the maintenance and upkeep of the Tekari Forts, observance of Durga Puja and other purposes specified therein, and in the event of the settlor dying before payment and discharge of the debts and liabilities set out in Schedule "D" and without making any permanent trust for the purposes enumerated, the settlor enjoined the trustees after discharge of the debts mentioned in Schedule "D" to set apart property fetching a net income of Rs

This deed was modified by a deed of rectification dated December 22, 1941, reciting that with the consent of all persons who were parties to the deed of trust, it was directed that at any time during the lifetime of the assessee, the assessee had the power to revoke or vary, either wholly or partly, the trust or any provisions of the deed of trust, but not so as to affect the payment and discharge of the debts and liabilities as mentioned in Schedule "D" thereto and the original deed of trust shall be read and construed as if it contained a power vested in the settlor (the assessee) during her life by deed to revoke or vary, either wholly or partly, the trust or any provisions of the said trust, but not so as to affect the payment and discharge of the debts and liabilities as mentioned in Schedule "D".

Another deed called a deed of amendment was executed by the assessee on January 12, 1942. By this deed paragraphs, 22, 32, 33, 35, 36 and 37 of the original deed were cancelled and other paragraphs including paragraphs 23, 24 and 42 were amended and modified and paragraphs 42(a),

44 and 45 were added. By the amendment of paragraph 23 the surplus rents, issues and profits of the trust property were to be divided in seven equal shares and by the amendment made in clause 24 it was provided that in the event of the death of any of the sons, his share of the rents, issues and profits shall become payable to his heir or heirs. By the modification in paragraph 42 it was provided that the trust under the deed may terminate after payment of the debts and liabilities of the trust that would then be outstanding or after extinguishment of the Thicca leases in favour of the Maharajadhiraj of Darbhanga or in favour of Capt. Maharaj Kumar Gopal Saran Narain Singh of Tekari, whichever event shall occur last. Paragraph 42(a)

"That the settlement made under these presents shall be permanent, unalterable and irrevocable so far as the interest created under these presents are concerned, but each beneficiary shall have full right to make any sort of arrangement about devolution or succession or make such alienation, as he may think fit, about his share, but the trust created under these presents shall be irrevocable so long as the debts mentioned above including all the liabilities on the Trust property up to date are not fully paid up or discharged or so long as the Thicca leases in favour of Hon'ble Maharajadhiraj of Darbhanga or Capt. Maharaj Kumar Gopal Saran Narain Singh remain good and effective, whichever event shall happen last.

Provided that always paragraph 43 of the Indenture of Trust dated 20th January, 1941, shall henceforth be read subject to this paragraph..."

In proceedings for assessment for the assessment year 1947-48 the Income-tax Officer, Gaya-Palamau Circle, Gaya, rejected the contention raised by the assessee that the income under the trust was taxable in the hands of the trustees under the deed of settlement and applying the provisions of section 16(1)(c) of the Indian Income-tax Act, 1922, brought the income of the trust to tax as part of the assessee's income. The order passed by the Income-tax Officer was confirmed in appeal by the Appellate Assistant Commissioner, but the Income-tax Appellate Tribunal reversed that order. The Tribunal observed that "revocation involved taking back that which was given once, but in the present case there was nothing done by the assessee by which it could be said that she had taken back what she had given by the original deed of trust", and the trust was therefore not a revocable trust as contemplated by section 16(1)(c) of the Income-tax Act.

The High Court of Judicature at Patna directed the Income-tax Appellate Tribunal under section 66(2) of the Act to state a case and to refer the following questions :

"(1) Whether the trust created by the assessee is a revocable trust within the meaning of section 16(1)(c) of Income-tax Act ?

(2) Whether the income from the property which is the subject-matter of the settlement mentioned in question (1) can be deemed to be the income of the assessee under section 16(1)(c) of the Income-tax Act ?"

The High Court held that the deed of trust dated January 20, 1941 (as modified by the subsequent deed dated January 12, 1942), was within the meaning of section 16(1)(c) of the Income-tax Act a revocable trust, but not being revocable for six years from the date of its creation, by virtue of the third proviso to section 16(1)(c) which controlled not merely the substantive provisions of section 16(1)(c) but the first proviso to that section as well, the income received by the beneficiaries (other than the settlor) under the deed of trust was not liable to be included in the income of the assessee.

The High Court accordingly directed that the income of the trust property which is the subject-matter of the settlement of the trust was not liable to be assessed to tax under the third proviso to section 16(1)(c), but only so long as the power of revocation granted by the deed was not exercised by the assessee under the terms of the deed or trust. The High Court also declared that the assessee was liable to pay tax

Against the order passed by the High Court, with special leave, the Commissioner of Income-tax, Patna, had appealed to this court.

The principal question which falls to be determined in this appeal is whether by the third proviso to clause (c) of section 16(1), income received by the beneficiaries other than the assessee is income arising to them by virtue of a settlement which is not revocable for a period exceeding six years, and from which income the assessee derives no benefit direct or indirect. Section 16(1)(c) provides :

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

(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 (VII of 1939), from assets remaining the property of the settlor or disponer, shall be deemed to be income of the settlor or disponer, 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, disponer or transferor, or in any way gives the settlor, disponer or transferor a right to reassume power directly or indirectly over the income or assets :

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

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 lifetime of the person and from which income the settlor or disponer derives no direct or indirect benefit but that the settlor shall be liable to be assessed on the the said income as and when the power to revoke arises to him."

The High Court held that the deed of trust was one in which the assets remained the property of the settlor, but as the trust was not revocable for a period of six years, the income received by the beneficiaries (other than the assessee) was not liable to be taxed as the assessee's income till the power to revoke arose in his favour.

The point in dispute in this appeal is about the applicability of the third proviso to section 16(1)(c), which seeks to exempt from the operation of the principal clause income which arises to any person under the deed of settlement executed by the assessee. Two conditions are necessary for the application of the third proviso - (i) that the trust should not be revocable for a period exceeding six years or during the lifetime of the beneficiary and (ii) the settlor or disponer should have not direct

or indirect benefit from the income given to the beneficiary.

Counsel for the Commissioner contended in the first instance that the third proviso to the section 16(1)(c) applied to the trust created by the assessee because in fact within six years of the date of its execution the deed was revoked, and that in any event on a true interpretation of the covenants of the deed of trust it was revocable six years. The plea that the trust was in fact revoked within six years was never raised before the revenue authorities, the Tribunal or even the High Court, and is plainly unsustainable. There are, it is true, certain recitals made in the deed dated September 18, 1946, executed by the assessee, which is styled "deed for further alternation of trust" by the assessee, that the liabilities referred to in Schedule "D" to the deed of trust dated January 20, 1941, had been fully discharged and the beneficiaries had been receiving the surplus rents, issues and profits according to their respective shares in the same and the settlor had by a deed of trust dated May 28, 1946, conveye

It may be noticed that whereas under the original clause 43 of the deed of trust dated January 20, 1941, even though the trust was expressly made revocable, it could not be revoked before payment of the debts and discharge of the liabilities mentioned in Schedule "D". By the 45th clause which was added by the deed of amendment dated January 12, 1942, the settlement made under the deed was declared permanent, unalterable and irrevocable so far as the interest created under the deed of amendment was concerned, and was also to stand irrevocable so long as the debts mentioned in Schedule "D" and other liabilities of the trust including all the liabilities on the trust properties were not fully paid up and discharged and so long as the leases in favour of the Maharajadhiraj of Darbhanga or Capt. Maharaj Kumar Gopal Saran Narain Singh remained good and effective, whichever event last happened. It is conceded that the lease in favour of the Maharajadhiraj of Darbhanga was to enure till 1965 and the lease in favour

It was urged on behalf of the Commissioner in the alternative that the third proviso to section 16(1)(c) did not protect the assessee against the application of the substantive part of that clause, because the assessee was deriving under the terms of the deed of trust a direct benefit. There are in the third proviso two cumulative conditions on the existence of which the exemption from liability to have the income arising from a settlement included in the assessee's income. The effect of the two conditions is that, that part of the income which arises to any person by virtue of the settlement which is not revocable for a period of six years or which is not revocable during the lifetime of the beneficiary will not be included in the settlor's income, provided that from the income of such person the settlor derives no benefit direct or indirect. The third proviso to section 16(1)(c) does not operate to exclude the income, which the settlor receives as a beneficiary, from liability to income-tax, it merely excl

Finally, it was contended that the third proviso only operates in respect of deeds of settlements or disposition which are referred to in clause (c), but not to deeds of settlement or disposition which by the first proviso are deemed to be revocable in the conditions mentioned by the first proviso. In other words, it is submitted the benefit of the proviso is not available in those cases where the settlement or disposition is deemed by the proviso to be revocable, because it contains a provision for the retransfer directly or indirectly of the income or assets to the settlor, or in any way it gives the settlor, disponent or transferor a right to reassume power directly or indirectly over the income or assets. We are unable to agree with this contention also. By the first proviso, settlements, dispositions or transfers of the character described therein, are deemed revocable for the purpose of the principal clause. The function of proviso 1 and proviso 2 is plainly explanatory. The second proviso in terms says

In a case decided by the Bombay High Court in *Ramji Keshavji v. Commissioner of Income-tax Kania J.*, in considering the scheme of section 16(1)(c), observed :

"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 law next specifies by proviso 1 what would be deemed a revocable transfer, in spite of the deed being apparently irrevocable. The relevant question for that proviso is this : Is this transfer revocable because it fulfils the conditions contained in the proviso ? The answer to that question can be only, it is revocable, or it is not. If the answer is in the negative, no further discussion can arise because, on the face of it, the deed is not revocable and, therefore, it does not come under section 16(1)(c). If, however, the answer to the question is in the affirmative, the deed although ostensibly irrevocable, is deemed to be revocable, and thus becomes a revocable transfer of assets, within the meaning of the substantive provision of section 16(1)(c). Having reached that stage, the law proceeds to consider further what is found in proviso 3. The s

In our view that passage correctly summarises the effect of the third proviso to section 16(1)(c).

The High Court was, therefore, right in holding that by virtue of the third proviso to section 16(1)(c) of the Indian Income-tax Act, 1922, the income received by the beneficiaries under the deed or trust other than the assessee could not, until the power of revocation arose to the assessee, be deemed to be the income of the assessee for the purpose of assessment to income-tax.

The appeal fails and is dismissed with costs.

Appeal dismissed.

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