SUPREME COURT OF INDIA

Commissioner of Wealth Tax, Hyderabad

Vs

Trustees of HEH

16/04/2003

(CJI., R.C. Lahoti, B.N. Agrawal, S.B. Sinha & AR. Lakshmanan.)

W I T H Appeal (civil) 4703 of 1999 CIVIL APPEAL NOS. 4962/1999, 7102/1999, 2519/2000, 2640/2000, 5688/1999, 1794/2000, 1809-1811/2000, 6170/1999, 4913/1999, 6074/1999, 4914/1999, 4316/1999, 5636/1999. 7459/2000, 4912/1999, 5616/1999, 820/2000 AND 2354/2000.

JUDGMENT

S.B. SINHA, J :

Noticing a purported conflict in the decisions of this Court in Bharat Hari Singhania and Others vs. Commissioner of Wealth Tax (Central) and Others [(1994) Supp. (3) SCC 46] = [(1994) 207 ITR 1] and The Commissioner of Wealth Tax, Andhra Pradesh, Hyderabad vs. Trustees of H.E.H. Nizam's Family (Remainder Wealth Trust), Hyderabad [(1977) 3 SCC 362] =[(1977) 108 ITR 555], a Division Bench of this Court by an order dated 1.11.2002 referred this matter to this Bench observing :

"We do see some force in the arguments of the learned counsel for the respondent that on facts it could be said that the decision in Nizam's Family Trust case (supra) is more akin to the facts of the appeals before us now. But then we do not agree with the learned counsel for the respondent that what is stated in Hari Singhania's case (supra) is only an obiter of an issue decided on facts. A perusal of the judgment extracted hereinabove clearly shows that this Court in Hari Singhania's case (supra) has in specific terms laid down the principle that in cases where the statute creates a legal fiction for determination of market value, no amount like provision for taxation, PF and gratuity etc. can be deducted from the market value of the estate while evaluating the estate for the levy of wealth-tax. If this be the correct principle in law then it will not be possible for the respondents to contend that the value of the estate duty payable, if any, should be deducted from the market value of the estate while determining the wealth-tax. If the principle what we have understood it to be, enunciated in the Hari Singhania's case (supra) is correct then the same, in our opinion, runs counter to the earlier decisions of this Court in the case of Nizam's Family Trust (supra) and both judgments being judgments of a Bench of three Judges, we think it appropriate that this issue should be settled by a larger Bench. Therefore, we direct that the papers of these appeals and connected matters be placed before the Hon. C.J.I. for appropriate orders."

The fact of the matter as noticed by the High Court is as under :-

The assesses are all beneficiaries of a Trust called H.E.H. the Nizam Jewellery Trust. They returned the value of their interest in the Trust properties on the basis of the valuer's report. The Wealth Tax Officer accepted the returns. In some cases, the Commissioner of Wealth Tax considered such assessments to be erroneous and prejudicial to the Revenue. In other case, the Wealth Tax Officer, himself reopened the assessments. The view of the Department was that the valuation made by the assessees valuer was incorrect for three reasons, namely, (i) that the Estate Duty payable on the death of the life tenant was wrongly deducted, (ii) that no adjustment has been made for appreciation in the value of the property; and (iii) that the interest rate was wrongly taken at 6 per cent or the purpose of actual valuation.

The Tribunal rejected these three grounds on finding that the accepted method of valuing the remaindermen's interest included a deduction of the Estate Duty, that the value had been taken on the basis of the Department, valuer's report and so did not call for appreciation and that the interest rate adopted was given in the table annexed to Wealth-tax rules itself.

The Tribunal made a reference to the High Court, inter alia, on the following question:

"1. Whether on the facts and in the circumstances of the case, the ITAT is correct in law in holding that the probable Estate Duty payable on the death of the life tenant has to be taken into account and the value of the property will be diminished by that for charge of W.T. in the hands of the remaindermen?"

The High Court answered the question in affirmative, i.e., in favour of the Assessee and against the Revenue, relying on the decision of this Court in H.E.H. Nizam (supra).

On an application made under Section 261 of the Income Tax Act by the Revenue, the High Court referred the following questions for this Court's consideration holding that it was a fit case for appeal to this Court :

"1) Whether the Hon'ble Court was justified in holding that the Estate Duty liability arising on the assumed death of life interest holder on notional basis is liable to be deducted from the valuation of the asset in the context of valuation of interest of the remainder interest holder ?

2) Whether the view of the Hon'ble Court runs counter to the decision of the Supreme Court in 207 I.T.R. (1)?"

Mr. R.P. Bhatt, learned Senior Counsel appearing on behalf of the Appellant, would submit that the High Court went wrong in interpreting the provisions of Sections 21(1) and 24 of the Wealth Tax Act, 1957 insofar as it failed to appropriately apply the legal fiction created thereunder. The learned counsel would contend that the High Court should have followed Singhania's case (supra).

Mr. Bhatt would urge that having regard to the provisions contained in Section 21 of the Wealth Tax Act, the same principles of valuation would apply in relation to the jewelleries held by remaindermen despite the fact that the persons having life interest in the Trust are alive.

Mr. S. Ganesh, learned Senior Counsel appearing on behalf of the respondent, on the other hand, would submit that the valuation of the jewelleries will have to be assessed having regard to what a willing and informed buyer would offer therefor, and then in determining the value the estate duty liability would be a relevant factor. Apart from the decision of this Court in Nizam's Family's case (supra), the learned counsel also relied upon Commissioner of Wealth-Tax, Bihar vs. Maharaja

Kumar Kamal Singh [(1984) 146 I.T.R. 202].

It is not in dispute that the jewelleries which are the subject matter of Trust are not in possession of the remaindermen, who are the ultimate beneficiaries. The respondents have also averred in their counter affidavit that in similar situations 'estate duty' had been charged in the past.

The question, therefore, must be answered having regard to the relevant provisions of the Wealth Tax Act vis--vis the Estate Duty Act.

Section 3 of the Wealth Tax Act is the charging Section in terms whereof a tax in respect of the net wealth on the corresponding valuation date of every individual is payable. The valuation of the net wealth, in view of Section 7 indisputably is required to be made in terms of clause (18) occurring in Part G of Schedule III appended to the Wealth Tax Act which provides that the value of the jewellery shall be estimated to be the price which it would fetch if sold in the open market on the valuation date.

As regards the liability of a Trustee, Section 21(1) of the Wealth Tax Act provides that the wealth tax, inter alia, shall be levied upon and recoverable from the manager or trustee, as the case may be, in the case of assets chargeable to tax thereunder. Sub-section (4) of Section 21 reads as under : "(4) Notwithstanding anything contained in the foregoing provisions of this section, where the shares of the persons on whose behalf or for whose benefit any such assets are held are indeterminate or unknown, the wealth-tax shall be levied upon and recovered from the court of wards, administrator-general, official trustee, receiver, manager, or other person aforesaid, as the case may be, in the like manner and to the same extent as it would be leviable upon and recoverable from an individual who is a citizen of India and resident in India for the purposes of this Act, and - (a) at the rates specified in Part I of Schedule I; or (b) at the rate of three per cent, whichever course would be more beneficial to the revenue : Provided that in a case where - (i) such assets are held under a trust declared by any person by will and such trust is the only trust so declared by him; or (ia) none of the beneficiaries has net wealth exceeding the amount not chargeable to wealth-tax in the case of an individual who is a citizen of India and resident in India for the purposes of this Act or is a beneficiary under any other trust; or (ii) such assets are held under a trust created before the 1st day of March, 1970, by a non- testamentary instrument and the Assessing Officer is satisfied, having regard to all the circumstances existing at the relevant time, that the trust was created bona fide exclusively for the benefit of the relatives of the settlor or where the settlor is a Hindu undivided family, exclusively for the benefit of the members of such family, in circumstances where such relatives or members were mainly dependent on the settlor for their support and maintenance; or (iii) such assets are held by the trustees on behalf of a provident fund, superannuation fund, gratuity fund, pension fund or any other fund created bona fide by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or profession, wealth-tax shall be charged at the rates specified in Part I of the Schedule I. Explanation 1 : For the purposes of this sub- section, the shares of the persons on whose behalf or for whose benefit any such assets are held shall be deemed to be indeterminate or unknown unless the shares of the persons on whose behalf or for whose benefit such assets are held on the relevant valuation date are expressly stated in the order of the court or instrument of trust or deed of wakf, as the case may be, and are ascertainable as such on the date of such order, instrument or deed. Explanation 2 : Notwithstanding anything contained in section 5, in computing the net wealth for the purposes of this sub-section or sub-section (4A) in any case, not being a case referred to in the proviso to this sub-section, any assets referred to in clauses (xv), (xvi), (xxii), (xxiii), (xxiv), (xxv), (xxvi), (xxvii), (xxviii) and (xxix) of sub-section (1) of that section shall not be excluded."

The core question which, thus, arises for consideration is as to whether the amount of estate duty payable on the deemed death of the life tenant would be a relevant factor in determining the valuation of the property. It is not in dispute that on the death of holder of the life-interest, the provisions of the Estate Duty Act would be applicable. The estate duty so determined in terms of sub-section (2) of Section 74 of the Act shall be the first charge on such interest.

There cannot, therefore be any doubt or dispute that the position has to be evaluated having regard to the value of the assets assessable at each relevant date. It is further not in doubt or dispute that the value of the jewelleries would be the price which a willing or informed buyer would offer therefor. As arrears of the estate duty would be a charge on the property, the same being 'encumbrance', the potential estate duty liability shall be a relevant factor while determining the market value of the jewelleries. Whenever there is a charge or encumbrance in the property, the right of a seller to sell the same would be subject to such charge. The restrictions and disadvantages attached to the right of the assessee would indisputably diminish the value of the property to the said extent.

In Mrs. Khorshed Shapoor Chenai vs. Assistant Controller of Estate Duty, A.P. [(1980) 122 I.T.R. 21], while considering the question as to whether a right to receive extra or further compensation is a separate right, this Court observed :

"In our opinion, the High Court was right in holding that there are no two separate rights - one a right to receive compensation and other a right to receive extra or further compensation. Upon acquisition of his lands under the Land Acquisition Act the claimant has only one right which is to receive compensation for the lands at their market value on the date of the relevant notification and it is this right which is quantified by the Collector under Section 11 and by the Civil Court under Section 26 of the Land Acquisition Act. It is true that under Section 11 the Collector after holding the necessary inquiry determines the quantum of compensation by fixing the market value of the land and in doing so is guided by the provisions contained in Sections 23 and 24 of the Act - the very provisions by reference to which the Civil Court fixes the valuation. It is also true that the Collector's award is, under Section 12, declared to be, except as otherwise provided, final and conclusive evidence as between him and the persons interested. Even so, it is well settled that in law the Collector's award under Section 11 is nothing more than an offer of compensation made by the government to the claimants whose property is acquired. (Vide Privy Council decision in Ezra v. Secretary of State for India [(1905) ILR 32 Cal 605] and this Court's decisions in Raja Harish Chandra v. Dy. Land Acquisition Officer [(1962) 2 SCR 676]; [AIR 1961 SC 1500] and Dr. G. H. Grant v. State of Bihar [(1965) 3 SCR 576]; [AIR 1966 SC 237]. If that be the true nature of the award made by the Collector then the question whether the right to receive compensation survives the award must depend upon whether the claimant acquiesces therein fully or not. If the offer is acquiesced in by total acceptance the right to compensation will not survive but if the offer is not accepted or is accepted under protest and a land reference is sought by the claimant under Section 18, the right to receive compensation must be regarded as having survived and kept alive which the claimant prosecutes in a Civil Court. It is impossible to accept the contention that no sooner the Collector has made his award under Section 11 the right to compensation is destroyed or ceases to exist or is merged in the award, or what is left with the claimant is a mere right to litigate the correctness of the award. The Claimant can litigate the correctness of the award because his right to compensation is not fully redeemed but remains alive which he prosecutes in Civil Court. That is why when a claimant dies in a pending reference his heirs are brought on record and are permitted to prosecute the reference. This, however, does not mean that the Civil Court's evaluation of this right done subsequently would be its valuation as at the relevant date either under the Estate Duty Act or the Wealth Tax Act. It will be the duty of the assessing authority under either of the

enactments to evaluate this property (right to receive compensation at market value on the date of relevant notification) as on the relevant date (being the date of death under the Estate Duty and valuation date under the Wealth Tax Act). Under Section 36 of the Estate Duty Act the assessing authority has to estimate the value of this property at the price which it would fetch if sold in the open market at the time of the deceased's death. In the case of the right to receive compensation, which is property, where the Collector's award has been made but has not been accepted or has been accepted under protest and a reference is sought or is pending in a Civil Court at the date of the deceased's death, the estimated value can never be below the figure quantified by the Collector because under Section 25(1) of the Land Acquisition Act Civil Court cannot award any amount below that awarded by the Collector; the estimated value can be equal to the Collector's award or more but can never be equal to the tall claim made by the claimant in the reference nor equal to the claim actually awarded by the Civil Court inasmuch as the risk or hazard of litigation would be a detracting factor while arriving at a reasonable and proper value of this property as on the date of the deceased's death. The assessing authority will have to estimate the value having regard to the peculiar nature of the property, it's marketability and the surrounding circumstances including the risk or hazard of litigation looming large at the relevant date. The first contention of counsel for the appellant, therefore, fails."

The view of ours also finds support from a decision of this Court in Commissioner of Wealth-Tax, Bihar (supra) wherein in estimating the value of the assets for the purpose of computation of compensation on vesting of lands under the Bihar Land Reforms Act, 1950, this Court held :

"But in estimating the value of the assets, this possibility, which is indeed in the nature of an obligation of the Compensation Officer, is a hazard, a clog or a hindrance which, if a proper estimate is made under s.7(1) by the WTO, he has to take into consideration. It is not a question of deducting the debt but a question of estimation of the value of the asset in question."

This Court in Nizam's Family's case (supra) categorically held :

"It is also necessary to notice the consequences that seem to flow from the proposition laid down in section 21, sub-section (1) that the trustee is assessable 'in the like manner and to the same extent' as the beneficiary. The consequences are three fold. In the first place, it follows inevitably from this proposition that there would have to be as many assessments on the trustee as there are beneficiaries with determinate and known shares, though for the sake of convenience, there may be only one assessment order specifying separately the tax due in respect of the wealth of each beneficiary. Secondly, the assessment of the trustee would have to be made in the same status as that of the beneficiary whose interest is sought to be taxed in the hands of the trustee. This was recognized and laid down by this Court in N.V. Shanmugham & Co. vs. C.I.T. [(1970) 2 SCC 139]. And lastly, the amount of tax payable by the trustee would be the same as that payable by each beneficiary in respect of his beneficial interest, if he were assessed directly."

It was further held :

"This immediately takes us to the question as to which of the two sub-sections, (1) or (4) of Section 21 applies for the purpose of assessing the assessees to wealth tax in respect of the beneficial interest in the remainder qua each set of unit or units allocated to the relatives specified in the Second Schedule. Now it is clear from the language of Section 3 that the charge of wealth tax is in respect of the net wealth on the relevant valuation date, and, therefore, the question in regard to the applicability of sub-section (1) or (4) of Section 21 has to be determined with reference to the

relevant valuation date. The Wealth Tax Officer has to determine who are the beneficiaries in respect of the remainder on the relevant date and whether their shares are indeterminate or unknown. It is not at all relevant whether the beneficiaries may change in subsequent years before the date of distribution, depending upon contingencies which may come to pass in future. So long as it is possible to say on the relevant valuation date that the beneficiaries are known and their shares are determinate, the possibility that the beneficiaries may change by reason of subsequent events such as birth or death would not take the case out of the ambit of sub-section (1) of Section 21. It is no answer to the applicability of sub- section (1) of Section 21 to say that the beneficiaries are indeterminate and unknown because it cannot be predicated who would be the beneficiaries in respect of the remainder on the death of the owner of the life interest. The position has to be seen on the relevant valuation date as if the preceding life interest had come to an end on that date and if, on that hypothesis, it is possible to determine who precisely would be the beneficiaries and on what determinate shares, sub- section (1) of Section 21 must apply and it would be a matter of no consequence that the number of beneficiaries may vary in the future either by reason of some beneficiaries ceasing to exist or some new beneficiaries coming into being"

This Court clearly observed that the position is as if the preceding life interest had come to an end on that date and if upon that hypothesis, it is possible to determine who precisely would be the beneficiaries and on what determinate shares, sub-section (1) of Section 21 would apply and it would be a matter of no consequence that the number of beneficiaries may vary in the future either by reason of some beneficiaries ceasing to exist or some new beneficiaries coming into being.

The effect of a legal fiction created by a statute is no longer res integra.

In Bhavnagar University vs. Palitana Sugar Mill Pvt. Ltd. & Ors. [(2003) 2 SCC 111], it was held :

"The purpose and object of creating a legal fiction in the statute is well-known. When a legal fiction is created, it must be given its full effect. In East End Dwelling Co. Ltd. v. Finsbury Borough Council, [(1951) 2 All.E.R 587], Lord Asquith, J. stated the law in the following terms:-

"If you are bidden to treat an imaginary state of affairs as real, you must surely, unless prohibited from doing so, also imagine as real the consequences and incidents which, if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanied it. One of these in this case is emancipation from the 1939 level of rents. The statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs."

The said principle has been reiterated by this Court in M. Venugopal v. Divisional Manager, Life Insurance Corporation of India, Machilipatnam, A.P. & Anr. [(1994) 2 SCC 323]. See also Indian Oil Corporation Limited v. Chief Inspector of Factories & Ors.etc., [(1998) 5 SCC 738], Voltas Limited, Bombay v. Union of India & Ors.,[(1995) Supp. 2 SCC 498], Harish Tandon v. Addl. District Magistrate, Allahabad, U.P. & Ors. [(1995) 1 SCC 537] and G. Viswanathan etc. v. Hon'ble Speaker, Tamil Nadu Legislative Assembly, Madras & Anr. [(1996) 2 SCC 353]."

Once the legal fiction under the Act is taken to its logical corollary, the conclusion is inescapable that while assessing the net wealth of the jewelleries in question, the charge created thereupon in terms of Section 74(2) of the Estate Duty Act will have to be taken into consideration.

Bharat Singhania's case (supra) whereupon strong reliance has been placed by Mr. Bhatt cannot be

said to have any application in the instant case.

This Court posed six questions as would appear from paragraph 9 of the judgment.

The question as to whether the Valuation Officer is bound by Rule 1- D or not was answered in the affirmative.

As regards the question as to whether the application of the break-up method in Rule 1-D means that the capital gains tax, which would be payable in case the said shares are sold on the valuation date, is liable to be deducted from the market value determined, it was held :

"The contention of the learned counsel, in this behalf, is rather involved if not obscure. The argument runs thus : Section 7(1) says that the value of an asset shall be the price which such asset would fetch if sold in the open market on the valuation date. In other words, the sub-section creates a fiction of sale of such asset on the valuation date for the purpose of determining its market value. Once a fiction is created, it must be carried to its logical extent and the court should not allow its imagination to be boggled by any other considerations. If an asset is sold, it would be subject to capital gains tax. For finding out the net wealth received in the hands of assessee, one must necessarily deduct the capital gains tax. Then alone one can arrive at the net price which the assessee will receive - and that should be the market value. We must say that the entire argument is misplaced. There is no sale of the asset and there is no question of capital gains tax being attracted or being paid. For the purpose of determining the market value, the sub-section says that the Wealth Tax Officer shall make an estimate of the price which the asset would fetch if sold in the open market on the valuation date. The sub-section speaks of the market value of the asset and not the net income or the net price received by the assessee. This is not a case where a fiction is created by Parliament. It is only a case of prescribing the basis of determination of market value. On the same reasoning, it must be held that no other amounts like provision for taxation, provident fund and gratuity etc. can be deducted. The contention of the learned counsel for the assessees is, therefore, wholly unacceptable."

This Court in that case was concerned with the applicability of Rule 1-D of the Wealth Tax Rules, 1957 which lays down the criteria for determining the valuation of shares.

Explanation II appended to Rule 1-D is as under :

"Explanation II : For the purposes of this rule

(i) the following amounts shown as assets in the balance-sheet shall not be treated as assets, namely

(a) any amount paid as advance tax under Section 18-A of the Indian Income Tax Act, 1922 (11 of 1922), or under Section 210 of the Income Tax Act, 1961 (43 of 1961);

(b) any amount shown in the balance-sheet including the debit balance of the profit and loss account or the profit and loss appropriation account which does not represent the value of any asset;

(ii) the following amounts shown as liabilities in the balance-sheet shall not be treated as liabilities, namely

(a) the paid-up capital in respect of equity shares;

(b) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the valuation date at a general body meeting of the company;

(c) reserves, by whatever name called, other than those set apart towards depreciation;

(d) credit balance of the profit and loss account;

(e) any amount representing provision for taxation [other than the amount referred to in clause (i)(a)] to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto; (f) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares."

The following principles emerge from the said decision :

(a) What is relevant is the market value of the shares i.e. what sale price the shares would fetch if sold in the open market on the valuation date.

(b) There is no legal fiction of sale created by Parliament; and therefore no deemed capital gains tax on sale is to be considered.

(c) The net realization by the assessee after meeting expenses is not material.

It is very important to note that this judgment was not concerned with what price a buyer would offer for the shares on the valuation date but only whether the seller can claim certain deductions from the price which the buyer would be willing to offer. In this case, however, this Court is only concerned what price the buyer would offer for the interest of the remainderman.

There cannot be any doubt or dispute that the question as regards capital gains liability will not affect the value of the shares or land inasmuch the same is incurred by the seller. In such an event, therefore, the price which the buyer would be prepared to offer would not be affected by the seller's capital gains liability or any the expenses which may be incurred by him. On the other hand, the estate duty payable by the trustees on the termination of the life interest would be a relevant factor for determination of the price which a willing and informed buyer would offer for purchase of the remainder interest. The remainder interest is merely the right of the remainderman to receive an amount from the trustees on the termination of the life interest of the life tenant, the purchaser, therefore, would take into consideration any factor which would potentially reduce the amount that he would ultimately receive from the trustees towards his remainder interest. The risk or hazard of estate duty liability will have a direct impact on the purchaser of the remainder interest and, thus, will be a relevant factor for the purpose of determination of valuation of the interest to be held by the remainderman.

For the reasons aforementioned, we are of the opinion that the judgment of the High Court is correct. These appeals, thus, being devoid of any merits, are dismissed. However, in the facts and circumstances of the case, there shall be no order as to costs.