

# KERALA HIGH COURT

S. Venugopala Varma Rajah

Vs

Commissioner of Agricultural Income-tax

Income-tax Referred Case No. 44 of 1966, Trivandrum in R.A. No. 49 of 1966

(K.K. Mathew, T.S. Krishnamoorthy Iyer and V. Balakrishna Eradi, JJ.)

16.08.1967

## JUDGMENT

### **Mathew, J.**

1. This is a reference made at the instance of the assessee by the Agricultural Income-tax Appellate Tribunal under Section 60(1) of the Agricultural Income-tax Act, 1950, hereinafter referred to as the Act.

2. The questions referred are : (1) Whether the arrangements made in the karar of 1909 for the maintenance of the junior members of tharwad is a diversion of the tharwad income; (2) Whether the provisions of Sub-Section (1) of Section 9 of the Act are applicable only in cases of diversion of income and (3) Whether in the facts and circumstances of this case, the provisions of Sub-Section (1) of Section 9 read with the provisos thereof are applicable in assessing the income of the Hindu undivided family.

3. A Hindu undivided Marumakkathayam tharwad represented by its karnavan was assessed to agricultural income-tax for the year 1959-60 by the Agricultural Income-tax Officer, Chittoor, by his order dated 13-4-1961. The assessee had contended before the officer that there was a karar in the tharwad executed by all the members of the tharwad in the year 1909 (29-5-1909), by which the properties of the tharwad have been allotted to what may be called the "Rani Group" and the junior members of the tharwad for their maintenance that the income from the properties allotted is being taken by the "Rani Group" and the junior members and that the tharwad should not be assessed to tax in respect of the income so received by them. The Agricultural Income-tax Officer overruled the contention and assessed the tharwad on the entire income. The assessee preferred an appeal before Appellate Assistant Commissioner. The Appellate Assistant Commissioner held that the income from the properties allotted to the "Rani Group" should be excluded in computing the income of the tharwad, but that income from the properties allotted to the junior members should be included in the income of the tharwad. Against this decision, there was a further appeal before the Agricultural Income-tax Appellate Tribunal by the assessee. As there was no appeal by the Department against that part of the order directing the exclusion of the income of the "Rani Group" for computing the income of the assessee, the Tribunal only

concerned with the question whether the income received by the junior members should be included in the income of the assessee. The Appellate Tribunal held that :

"In view of our finding that the karar does not create any diversion of Income but only application of income, there seems to be no necessity for considering the other contention that the income could not be assessed at the hands of the appellant in virtue of the provision under Section 9(1) of the Act. We feel that provisions under Section 9(1) would come in only if there is diversion of income. It is such diverted income that is made taxable at the hands of the transferor under Section 9(1)." The appeal was therefore dismissed by the order of the Tribunal dated 5-2-1966.

4. There were 12 members in the tharwad at the time of the karar. All of them were parties to it. The properties mentioned in "A" schedule in the karar were set apart for the maintenance, education and all other expenses of the female and male members residing in Kalari Kovilagam. The karnavan, for the time being, is to see to the performance of the thalikettu kalyanam of the female members of the Kalari Kovilagam in accordance with the prevailing condition, and meet the expenses thereof. All the other expenses of male and female members residing in the Kalari are to be met from the income of 'A' schedule properties. The members residing in the Kalari have no right to alienate or encumber the properties allotted to them and all Government revenues due in respect of the properties are to be paid by them. Parties Nos. 7 and 8 in the karar had obtained from their father certain items included in 'A' schedule. Though the jenmam rights of these items were purchased with Kovilagam funds, the amount taken from the Kovilagam has mostly been recouped from the income of the properties and the aforesaid properties were agreed to be retained as "stree tavazhi" properties. The net income from the "A" schedule properties was estimated at 30785 paras of paddy and Rs. 1250 300 cartloads of paddy out of the Income has to be given for the years 1085, 1086 and 1087 (M. E.) to Party No. 1, who was the karnavan of the tharwad at the time. The surplus income from 'A' schedule properties has to be accumulated and properties acquired for the "stree tavazhi". The managing member of the tavazhi is to keep accounts of the income and expenditure and render account to the female members and to the karnavan for the time being. 'A' schedule properties and acquisitions out of the income therefrom would remain as "stree Tavazhi" properties of Kalari Kovilagam, and they shall be preserved in accordance with the marumakkathayam system without division.

5. Party No. 2 has been given 7000 paras of paddy annually for his maintenance and for this purpose paddy lands yielding 3,500 paras of paddy, shown in 'B' schedule, were given possession to him and Party No. 1 is directed to give Party No. 2, from 1085 onwards, 3500 paras of paddy, "Karukakode Challa Nilam" should be entrusted by Party No. 1 to Party No. 2 by a separate document after redeeming it. The above-mentioned 3500 paras of paddy need be given by Party No. 1 only till such entrustment is made. Party No. 2 and his successors-in-office are to enjoy the property.

6. 'C' schedule properties yielding an income of 4750 paras of paddy were allotted for maintenance to Party No. 3 and to persons who succeed to the stanom, then occupied by Party No. 3.

7. Properties in the 'D' schedule were set apart to Party No. 4 for his maintenance and for the maintenance of those who succeed to the stanom then occupied by him.

8. The land revenue of B, C and D schedule properties is to be paid by the karnavan for the time being.

9. Clause 17 of the Karar provides that 'A', 'B', 'C' and 'D' schedule properties should not be alienated, mortgaged or encumbered by the parties to whom the properties are allotted and if it is so done it will not be binding on the Kovilagam or the properties and that Party No. 1 will be entitled to resume the properties treating the transaction as void. By clause 18 the parties are prohibited from cutting and selling the kuzhikoors or dismantling the buildings on 'A', 'B', 'C' and 'D' schedules. By clause 19, it is provided that munpattom amounts due to the tenants of the properties in 'A', 'B', 'C' and 'D' schedules and mentioned in the 'E' schedule should not be enhanced by any of the parties to whom properties are allotted in excess of what is shown in the 'E' schedule. Clause 20 provided that the arrangement and stipulations made in the karar shall be a perpetual arrangement for all time and binding on all the members existing and to be born thereafter in the Kovilagam. These in substance are the provisions in the karar.

10. We are of opinion that this is a case where the tharwad had received the income from the properties allotted to the junior members and applied the same for the purposes of the tharwad. The junior members of the tharwad have a right to be maintained out of the income from the properties of the tharwad, and the arrangement in the karar was only a method for discharging the obligation of the tharwad in the matter of payment of maintenance to the junior members. Instead of the tharwad taking the income from the properties and distributing it to the members for their maintenance, the members of the tharwad were given the right to take the income from the various properties allotted to them and appropriate it for their maintenance. It is clear from the terms of the karar that there was no transfer of the properties from the tharwad to the allottees. The only right of the junior members is to take the income and appropriate it for their maintenance. The tax in respect of the properties allotted to the junior members has to be paid by the karnavan. The members received the income from the properties allotted, in their capacity as members of the tharwad and in discharge of the obligation of the tharwad to maintain them. Even assuming that the karar is a settlement or disposition of the income, we think that this is a case of application of the income of the tharwad and that the income passes through it, even though the assessee has entered into a legal obligation to apply it in that way.

11. In *Bejoy Singh Dudhuria v. Commissioner of Income-tax, Calcutta*<sup>1</sup>, the assessee succeeded to the family ancestral estate on his father's death. Subsequently, his stepmother, who had a legal right to maintenance out of the estate, brought a suit for maintenance against him and a consent decree was passed directing the assessee to

<sup>1</sup>(1933) 1 ITR 135 : AIR 1933 PC 145

pay a fixed monthly sum to his step-mother and declaring that the maintenance was a charge on the ancestral estate. It was conceded that the assessee was liable to be assessed as an individual and that he and his step-mother were not members of an undivided family. The Privy Council said that the sums paid by the assessee to his stepmother were not the income of the assessee at all. Lord Macmillan, in delivering the judgment of the Board, said :

"In the present case the decree of the court by charging the appellant's whole resources with a specific payment to his stepmother has to that extent diverted his income from him and has directed it to his step-mother; to that extent what he receives for her is not his

income. It is not a case of the application by the appellant of part of his income in a particular way, it is rather the allocation of a sum out of his revenue before it becomes income in his hands."

12. In *Mullick v. Commissioner of Income Tax, Bengal*<sup>2</sup>, the Privy Council had to consider a case of executors who had received the whole income of the estate and who applied a portion of it pursuant to the directions of the testator and other legal obligations. The Board said that payment of Addya Sradh expenses, the cost of probate, death duties and other debts due to the State, or periodic payments to beneficiaries out of the income of the estate in compliance with the obligatory directions of the testator cannot be excluded in computing the chargeable income of the estate.

13. In *Commissioner of Income-tax v. Makanji Lalji*<sup>3</sup>, Chief Justice Beaumont said that maintenance paid to a member of a joint family out of the joint family income is merely an application of a portion of the income of the joint family and cannot be deducted in computing the income of the joint family even though the amount of the maintenance was fixed by a decree of court and made a charge on the joint family properties. It would seem that the fact of the existence of a decree for maintenance creating a charge on the properties of the joint family for it would make a difference. That is probably the reason why the case was not quoted with approval by the Supreme Court in *Commissioner of Income Tax v. Sitaldas Tirathdas*<sup>4</sup>. In that case, the assessee sought to deduct amounts paid by him as maintenance to his wife and children under a decree of court passed by consent in a suit. No charge on any property of the assessee was created. It was held by the Supreme Court that it was a case in which the wife and children of the assessee, who continued to be members of his family, received a portion of the assessee's income after he had received it as his own, and was, therefore, one of application of a portion of the income to discharge an obligation and not one in which by an overriding charge the assessee became only a collector of another's income. Hidayatulla, J. said at p. 374 (of ITR) :

"In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation

<sup>2</sup>(1938) 6 ITR 206 : AIR 1938 PC 118

<sup>4</sup>(1961) 41 ITR 367 : AIR 1961 SC 728

<sup>3</sup>1937-5 ITR 539 : AIR 1937 Bom 479

cannot be said to be a part of the income of the assessee. Where by the obligation Income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable."

It will be noticed that the Privy Council decision in 1933-1 ITR 135 : (AIR 1933 P.C. 145) was a case where there was an antecedent obligation attaching to the estate. Therefore, what the assessee in that case inherited from his ancestor was the asset, less this liability. At the moment when the estate passed to him, this liability was not quantified and when it was so done by the decree of the court the entirety of the estate became, so to speak, charged with it and that that portion of the income payable to the step-mother had to be treated as the income of the step-mother and not of the assessee. The decision in (1938) 6 ITR 206 : (AIR 1938 P.C. 118) is an instance of the application of the income, that is, expenses, incurred by the assessee out of the income which has come to him. The distinction is between a case where the transfer is in pursuance of an antecedent obligation of the taxpayer, that is, where obligation exists de hors the will of the transferor, and a case, where the assessee has obliged himself by a voluntary act on his part to render certain income of his the income of another. The former class of cases would be treated as diversion; as flowing from an overriding previous title, sufficient to divest the assessee of the character of the recipient of that income. On the other hand, where the disposition arose out of a voluntary act on the part of the assessee, the fact that he created a binding obligation on himself to make the payment is held insufficient to alter its character as the income of the transferor, and the transaction is treated as an expenditure or an application of income, with the result that the disposition would be disregarded in computing the total income of the assessee. We think that the case at hand falls in the latter category.

14. The object of enacting Section 9(1) of the Act is somewhat similar to the one which was sought to be achieved by legislation in England. It is "designed to overtake and circumvent a growing tendency on the part of taxpayers to endeavour to avoid or reduce tax liability by means of settlements. Stated quite generally, the method consisted in the disposal by the taxpayer of part of his property in such a way that the income should no longer be receivable by him, while at the same time he retained certain powers over, or interests in, the property or its income. The Legislature's counter was to declare that the income of which the taxpayer had thus sought to disembarass himself should, notwithstanding, be treated as still his income and taxed in his hands accordingly." (See the observations of *Lord Macmillan in Chamberlain v. Commrs. of Inland Revenue*<sup>5</sup>,

15. Section 9(1) together with the third proviso reads :-

<sup>5</sup>(1943) 25 Tax Cas 317 at p. 329

"In computing the total agricultural income of an assessee all agricultural 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 this Act, from asset remaining the property of the settlor or disponent shall be deemed to be the agricultural income of the settlor or disponent and all agricultural income arising to any person, by virtue of a revocable transfer of asset shall be deemed to be the agricultural income of the transferor :  
X X X

Provided also that this sub-section shall not apply to any agricultural 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 agricultural income the settlor or disponent derives no direct or indirect benefit but that the settlor shall

be liable to be assessed on the said agricultural income as and when the power to revoke arises to him."

16. It was contended on behalf of the assessee that if a settlement or disposition of income is made, whether it be application or diversion of income, and that settlement or disposition satisfies the requirements of the third proviso, the income disposed of ceases effectively to be the income of the transferor. What Section 9(1) says is that where there is a revocable or non-revocable settlement or transfer of income, the income can be assessed in the hands of the settlor, or transferor, unless the case falls within the third proviso to the sub-section. In other words, under Sub-Section (1) of Section 9, every disposition of income is disregarded in computing the total income of the donor, but by reason of the third proviso, dispositions of a particular character and enuring for a particular duration are saved. We think that settlements or dispositions of income which are merely applications of income are not within Section 9(1), or the provisos thereto, while dispositions which are diversions of income are saved only when the conditions of the third proviso are satisfied. (See the observations of Rajagopala Ayyangar, J. in *A.R. Rangachari v. Commissioner of Income Tax*<sup>6</sup>).

17. Counsel for the assessee relied on the decision of the Supreme Court in *Commissioner of Income-tax, Bombay v. Ratilal Nathulal*<sup>7</sup>, and contended that the "settlor" in the instant case is tharwad and that there was an irrevocable transfer of the income of the properties to the junior members of the tharwad and that the third proviso to Section 9(1) was attracted. The transferor in that case was an undivided Hindu family and the transfer was by the execution of a trust deed by Ramjibhai and his son, Ratilal, the sole coparceners at the time, and the provision in the trust deed was that the income of "trust property" was to be enjoyed by Ramjibhai during his life-time and after his death by his son, Ratilal. The effect of the execution of the trust deed was that the properties ceased to belong to the joint family as also the income therefrom. When Ratilal, who was one of the beneficiaries under the trust, became the manager of the undivided family, the question arose whether this circumstance would enable the Revenue to assess the income derived from the trust properties as the income of the joint family. The court held that Hindu undivided family was a unit for the purposes of income-tax, and should be treated as an independent entity with the

<sup>6</sup>(1955) 28 I.T.R. 528 at p. 541 (Mad)

<sup>7</sup>(1954) 25 ITR 426 : AIR 1954 SC 503

result the income which the manager derived as a beneficiary under the trust could not be treated as the income of the family. In answer to the argument that, by virtue of the 2nd proviso to Section 16(1)(c) of the Indian Income-tax Act, corresponding to the 2nd proviso to Section 9(1) of the Act, Ratilal though only one of the two persons who executed the settlement deed, is the "settlor", and that the provision in the trust deed that the income was to be enjoyed by Ratilal after the death of Ramjibhai is, in substance, "a provision contained in the trust deed for a re-transfer of the income to the settlor", it was held that the fallacy of this argument consists in treating the respondent Ratilal as one out of the two settlors for the purpose of the second proviso while treating the family as the settlor for the purpose of the last portion of clause (c) of Section 16(1). If the settlor was the Hindu undivided family and the trust deed was executed by both the persons as the sole surviving coparceners, representing the Family, the second proviso, which treats one out of a group of settlors as the "settlor" cannot come into operation because the Hindu undivided family is a unit independent of and larger than the two coparceners and is not merely a collection of the individuals who acted on its behalf. This case, therefore, shows that the capacity

in which the assessee executed the deed of trust was quite distinct from his capacity as a beneficiary under the trust, which had been created by the family. There having been a transfer of property, and the property having by reason of such transfer ceased to belong to the family, there would have been no power in the taxing authorities to have included the income of the settlee in the income of the settlor but for section 16(1)(c), and as it was held that the third proviso was satisfied, the aggregation was not possible. The case cannot assist the assessee here for the reason that there was no transfer of any assets involved in the karar. In the case of a transfer of an asset where no interest accrues directly or indirectly to the settlor and the duration of the transfer is for the period exceeding six years or for the life-time of the grantee the transfer would be deemed an irrevocable transfer of assets and therefore outside the purview of Section 9(1) of the Act. In such cases, the income of the transferee would not statutorily be deemed to be the income of the transferor under Section 9(1) with the result that the immunity which attached to that income under the general law re-attached to it by reason of the exclusion of applicability to Section 9(1). In cases where there is no transfer of asset but a disposition of income the effect of satisfying the third proviso would be that the disposition would be treated as an irrevocable disposition and the income of the donee would not by statutory fiction be treated as part of the total income of the donor. But this does not necessarily mean that in any particular case the settlement of the income may not be an application of income. In other words, the effect of a disposition satisfying the requirements of the third proviso is merely to take it out of the scope of Section 9(1), namely, out of the statutory fiction created by the use of the expression "deemed" in the sub-section.

18. It was contended for the assessee that even if there must be a diversion under an overriding title, for applying Section 9(1), that title need not precede the title of the assessee and that it would be enough if the title of the transferee precedes the accrual of the income and that here the title to receive the income by the members preceded the receipt of the income by them, that that would override the title of the assessee and therefore it was under an overriding title that the junior members received the income. We cannot agree. The karar, so far as junior members are concerned, was only a maintenance arrangement, and the title to take the income from the properties allotted to the junior members was a title created by the voluntary act of the assessee, namely, the tharwad, which, included these members also. The receipt of the income by them under the karar is in their capacity as junior members. We do not think that receipt of the income by the junior members was under an overriding title; a title de hors the will of the assessee.

19. The matter may be looked at from a different angle to test the correctness of this proposition. Suppose a money decree binding on the tharwad is obtained, and the properties allotted to the junior members are sold in execution of that decree. Would it have been open to the junior members to contend that the purchaser must take the properties only subject to their right to receive the income from the properties for all time under the terms of the karar or that the properties are not liable to be sold in execution of the decree? Let the decree be for a debt incurred before or after the karar: Provided that it is binding on the tharwad, we think that it would not have been open to the junior members to contend that the properties allotted to them cannot be sold in execution or that the purchaser must take them subject to their right to receive the income from them under the karar, the reason being that the karar did not create a charge or an encumbrance on the properties for the maintenance payable to them. If the karar had created an overriding title in the junior members to receive the income from the properties allotted to them, we can see no reason why they could not have resisted the purchaser saying that they have an overriding title to receive the income from the properties under the karar, despite the purchase,

and that the purchaser should take them subject to that title. (In this connection, see the decision in *Parrakel Kondi Menon v. Vadakentil Kunni Penna*<sup>8</sup>,

20. We also think that there was no permanency about the arrangements for the maintenance of the junior members in the karar. The karar being executed by all the members of the tharwad, the tharwad which for the purpose of Section 9(1) is the "settlor", could have entered into any other arrangement or even revoked the karar at any time within six years. Clause 20 of the agreement stipulating for permanency of the arrangements in the karar has no greater sanctity than the other clauses in it so that it might be said that it is binding on the tharwad for all time.

21. Counsel for the Revenue referred to the rulings in *Ramji Keshavii v. Commissioner of Income Tax. Bombay*<sup>9</sup>, *Behramji Sorabji v. Commissioner of Income Tax*<sup>10</sup>, *K. Subramania Pillai v. Agricultural Income-tax Officer*<sup>11</sup>, and *Tarunendra Nath v. Commissioner of Income Tax*<sup>12</sup>, and submitted that clause 17 in the karar giving power to the first party, the karnavan, to re-assume any property allotted, in case it is alienated or encumbered, though contingent in nature would be sufficient to make the karar a revocable settlement within the meaning of the first proviso to Section 9(1), and therefore, the third proviso would not, in any event, be attracted. We find it unnecessary to express any opinion on this aspect, in view of our answers to the first and second questions.

22. We answer the first question in the negative and the second in the affirmative, both against the assessee and in favor of the department. The third question does not

<sup>8</sup>(1866) 2 Mad HCR 41

<sup>10</sup>(1948) 16 ITR 301 : AIR 1948 Bom 405

<sup>9</sup>1945-13 ITR 105 : AIR 1945 Bom 254

<sup>11</sup>(1964) 53 ITR 764 (Mad)

<sup>12</sup>AIR 1958 Cal 350

arise for consideration in view of our above answers.

23. The assessee will pay the costs of the department including counsel's fee Rs. 200.

24. A copy of this judgement will be sent to the Appellate Tribunal, Trivandrum, under seal of the Court and the signature of the Registrar.

Reference answered.