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SooperKanoon Citation : sooperkanoon.com/64577

Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Mar-25-1991

Reported in : (1991)37ITD422(Delhi)

Judge : A Kalyanasundharam

Appellant : Lalith Kumar Modi

Respondent : Assessing Officer

Judgement :

1. The assessee, an individual has filed these appeals, of which the main issue arises in the appeal for the assessment year 1984-85, and the issues of the other years are merely consequential.

2. The main issue relates to the claim of capital gain arising out of the sale of equity shares of Modi Rubber Ltd. to M/s Touchwood Investments (P.) Ltd., in which the relatives of the assessee were shareholders and directors. The assessee in the assessment year 1983-84 had sold 7000 equity shares of Modi Spg. & Weaving Mills Ltd., to the investment company and suffered a long term loss of Rs. 45,000. The assessee in the assessment year under appeal had sold 1599 equity shares of Modi Rubber Ltd., to the investment company, and realised a long term gain of Rs. 23,185. The assessee claimed the set off of the long term capital gain against the long term capital loss. The assessing officer found as a fact that, the shares of Modi Spg. & Weaving Mills Ltd. had not realized any dividend, while the shares of Modi Rubber Ltd. did yield some dividend and the

quantum of dividend received by the assessee was Rs. 3,198.

3. The assessing officer was of the opinion that, the sole purpose of floating the investment company was to evade tax by the individuals because, the investment company would be entitled to claim the deduction under Section 80M, which could not have been claimed by the assessee. Since the investment company was also held by the relatives of the assessee, the corporate entity was used by the assessee for perpetuating the tax avoidance. The shares of the investment company also being held by the relatives, the dividend by a circuitous method remained with the assessee in one way or the other. He then co-related the loss claimed in the earlier asst. year 1983-84 as a manner of careful planning of getting away from the payment of tax arising from the sale of long term assets. The assessing officer then related the facts of the assessee with the case of Workmen of Associated Rubber Industry Ltd. v. Associated Rubber Industry Ltd. [1986] 157 ITR 77 (SC) and reproduced the observation of the Supreme Court. He was of the impression that, in the Associated Rubber's case, the workmen's bonus was prejudiced by a similar method adopted by that company, i.e., floating an investment company which was wholly owned subsidiary company, to which shares of companies from which it was earning sizable dividend were transferred. The Supreme Court had struck down the transfer at the instance of the workmen, who pleaded that, by the transfer of the shares, their rightful bonus was denied to them. The assessing officer then invoked the Supreme Court ruling in McDowell & Co. Ltd. v. CTO [1985] 154 ITR 148 and observed that, perplexing schemes of tax avoidance should be uncovered and the real intention behind the transaction must be brought to surface.

4. In appeal before CIT(A), the assessee had taken up the claim on the ground that the transaction was genuine and that, the resultant benefit that accrued to the investment company was as per provision of the law and therefore, the transaction did not exhibit any scheme of tax avoidance. The CIT(A) was unmoved by the pleas of the assessee and he reproduced his observation in the case of Smt. Beena Modi vide order dated April 7,1989 and dismissed the plea of the assessee.

5. The plea of the counsel for the assessee Shri Vaish was that, the assessing officer has presumed the transaction to be colourable because the shares were sold in successive years and that too to the same company in view of the additional fact that the investment company happens to be a company in which the relatives of the appellant are directors and shareholders. He contended that, the assessing officer has no dispute on the fact that, the shares were sold at market price only and that, the assessee had no hand in the determination of the market value. He further contended that the primary objection is to the claim of set off of the capital gains against the brought forward capital loss. He pleaded that, the revenue had no objection to the transaction so long as the revenue recovers the tax, i.e., for the immediately preceding assessment year when the assessee had sold the shares and suffered loss, which was not claimed to be set off against the incomes, thereby, there was no reduction in the tax paid by the assessee. In the year under appeal, the assessee's tax amount got reduced by the set off and this was felt as an effort made in the direction of avoidance of tax. He pleaded that, no doubt the net effect was reduction in taxes but, what is provided by the Act, which only was claimed by the assessee, the administrator could not deny the same to the assessee by giving it an image of a scheme to avoid taxes. He further contended that, the investment company had held shares of other companies as well in addition to the shares of Modi group of companies.

He pleaded that, it is true that the assessee who is an individual cannot claim any deduction under Section 80M but that benefit which would be available to the company consequent to it having purchased the shares was not something that was conferred upon it by the appellant but by the Act itself. He contended that, if consequent to some transaction a company becomes entitled to some benefit under the Income-tax Act, as provided by the Act, merely because the transferor could not claim such a benefit could not be a criteria for holding the transaction to be a colourable one. He pleaded that, if this was the basis for consideration and evaluation of every transaction, especially if it involves two relatives, then, almost every transaction would be a colourable one. He pleaded that, the requirement of a transaction between two relatives is that, it must be at the same rate or price as would be between two strangers and in the instant case, the transaction is at the market price only. He referred to the Supreme Court ruling in CWT v. Arvind

Narottam [1988] 173 ITR 479 and submitted that, the limited application of the ratio of McDowell & Co.'s case was appreciated and that any benefit conferred by the statute, if availed by an assessee, resulting in avoidance of taxes, would not necessarily be bad. He also referred to the ruling of the Madras High Court in M.V.Valliappan v. ITO [1988] 170 ITR 238 for the proposition that, the principle of courts not to permit schemes of tax avoidance, where the scheme was devised to circumvent the law itself was not to be permitted was very well appreciated but they had very clearly observed that, it could not be assumed in every case. He, therefore, submitted that, the transaction being at arm's length, the appellant must be allowed set off of the capital loss against the capital gain and the consequently, the dividend should be excluded from the hands of the assessee, since it happened to be earned and received by the transferee company.

6. The DR placed heavy reliance on the orders of the authorities. Her main contention lay on the observation of the Supreme Court in CIT v.Durga Prasad More [1971] 82 ITR 540, that, the assessing officer should take into consideration all the surrounding circumstances and in the instant case, considering that, the transferee company belonged to the relatives only, the assessee could be said to be in indirect control over the shares and the only purpose was to claim loss and its set off against the gain, resulting in avoidance of taxes. He therefore, contended that, McDowell & Co. Ltd. (supra) ratio squarely applied to the present case.

7. The rival contentions have been duly considered as also the materials that have been placed on our record.

7.1 The admitted and undisputed facts in the instant case are : (a) the investment company was in existence for quite some time; (b) the investment company held shares of Modi group of companies as well as others ; (c) the company had been dealing in shares as is revealed from the details that certain shares which were held by it in one year, were not held by it in the following year; (d) the shares of that company were held by the family members and relatives of the assessee; (e) the shares of Modi Spg. & Weaving Mills Ltd. which were held by the assessee did not yield any dividend for the last few years; (f) these shares were sold in the immediately preceding asst. year at the prevailing market prices to the investment company, the assessee suffering a long term capital loss of Rs. 45,000 and the revenue did not go into the question whether the said transaction was colourable one in that asst. year, because, there was no effect on the total income and the resultant tax thereon; and (g) since in the asst. year under appeal, the assessee had sold 1599 shares of Modi Rubber Ltd. (on which it was getting a dividend of Rs. 2 per share) to the investment company at the prevailing market price and had a capital gain of Rs. 23,185 which was claimed to be set off against the brought forward capital loss of Rs. 49,500, the resultant effect being non-realization of taxes on the capital gains, the revenue had proceeded to examine the transaction as to whether it was a colourable one or not.

7.2 The revenue would not have objected to the said transactions had the sale been to a total stranger. The revenue would also have no objection had there been no claim for set off of the capital loss against the capital gain. The feeling of the revenue is that, since the sales were to the company in which the relatives of the appellant are shareholders and directors, this was something similar to assessee indirectly continuing to exercise control over the shares and therefore, this was a scheme to get benefit under the Act while still retaining control over the property.

7.3 Every transaction would always result in some benefit conferred upon the purchaser, such as title to the goods, income therefrom, etc.

Once the purchaser acquires the property in the goods, all future benefits that arise on that property are rightfully his and simply because, the purchaser would get that benefit, which was never available to the appellant is no ground for coming to the conclusion that, the transaction is a subterfuge. In the instant case since the investment company, being a company and the Income-tax Act confers upon it the benefit of allowing of deduction on inter-corporate dividends, which was not available to the appellant who is an individual, the assessee cannot be held to have devised any scheme because, the benefit is conferred upon an assessee not by the assessee but by the Statute.

Any benefit that accrues to any assessee consequent to any transaction by virtue of the provisions of the Act, under no circumstances can be held to be transferred by the transferor, because, the transferor could never do so and is beyond his power to do so. The transferor cannot even restrict such an allowance being granted to the purchaser because, the sale would be complete only when the entire property in the goods along with whatever benefits that can accrue on it is also transferred.

Is case of the seller transferring the goods with rider that all benefits that would arise in the future on those goods would belong to him alone, then there is no sale at all but would be a mere lease of the goods, which is not the same thing as a sale.

If we have to accept the proposition advanced by the revenue, then the conclusion has to be that, the shares were never sold, in which event, there would arise no capital gains at all and the gain of Rs. 23,185 would not attract any taxation. The fallacy in the argument lies on the fact that, the company would be entitled to deduction under Section 80M, which was not available to the assessee, thus, the company would also not be paying any tax on the dividend earned on those shares. On this feature, the assessee could not be said to have any control whatsoever, because, it is so conferred upon the company by the Statute.

Can the assessee be said to possess best of both the words, i.e., show or exhibit something as sold, claim the loss to be set off and at the same time still own it as well? The answer is an emphatic no. The assessee can exhibit something as sold only when the transaction tantamount to a sale and to this extent, in the instant case, there is no dispute by the revenue at all. The assessee no longer remains to own the shares is a resultant effect of the said sale. There is no dispute about the principle laid down by the Supreme Court in Durga Prasad More's case (supra), as to the right of examination by the revenue to evaluate the reality of a transaction and in the event of the transaction revealing a planned scheme to defeat the provisions of law, the transaction can never have the sanction of any court. For applying this ratio, it is very necessary to enlist out from the facts that, the transaction was a scheme to defeat the provisions of law. If the transaction is not effected at arm's length, and the Act bans any transaction between relatives or concerns in which those relatives are interested as either proprietors, partners or shareholders and the assessee has effected the transaction in such a manner which does not on the face of it appear to be a transaction not permitted by law, then, such a transaction would not stand the test of the above principle laid down by the Supreme Court. Therefore, merely because the transaction involves two related persons, that by itself is not conclusive for holding the transaction to be a scheme for avoiding of taxes.

The Supreme Court in CIT v. Karam Chand Thapar & Bros. (P.) Ltd. [1989] 43 Taxman 45 has clearly laid down that, it is the duty of the Tribunal to give a positive finding on the issues raised before it by taking into account the totality of the facts and circumstances. Unlike in the case of Associated Rubber (supra), in the instant case, no employee of the appellant is affected by the transfer of the shares and therefore, there is no detriment to any one. Simultaneously, the employees of Modi Rubber too are not affected by the said sale of their company's shares.

Therefore, to claim that the said transfer was a device affecting the interest of any party not concerned directly with the transaction is too far-fetched a proposition.

The Act allows certain deductions like for life premia payment, interest from banks and units, donations, etc., and if an assessee in order to avail the maximum deduction under the sections with a view to reduce his tax liability invests on these, he cannot be held to have devised any scheme. The Act similarly allows set off long-term capital loss against the long term capital gains and merely because, the assessee claims the set off, he could not be held to have devised any scheme to avoid taxes. No assessee can be held to have devised any scheme if he so arranges his affairs so as to reduce his tax liability, because, the Legislature have enacted various provisions of relief from taxes keeping in mind the country's development needs. The assessee by selling his shares in the earlier year at a loss, had in fact reduced his capital to that extent and by selling his shares at a profit, has recouped the reduction to his capital. The plea of the revenue that, the transaction would be acceptable, had the assessee not claimed any set off of the brought forward loss, since it would have realised taxes, clearly indicates that, the revenue had not the foresight that, this would ultimately wipe out the assessee himself, because combined with the reduction in his capital, if he is made to pay taxes, this would reduce further his capital, finally eroding to it to nil, which was never the intention of the Legislature. No country can survive or grow if it kills the growth of individuals or other persons. Therefore, the very philosophy of approach by the revenue that any transaction which results in the lowering of the realizable taxes is fraudulent one on the revenue needs a drastic reappraisal.

The ratio laid down by the Supreme Court in McDowell & Co. Ltd.'s case (supra) would apply to a situation, where the statute normally makes the manufacturer liable for excise duty, which was not so paid by him but by the purchaser and if the interpretation of the statute gives rise to any ambiguity as to who is liable. In the instant case, the transferor has not diverted what was liable on him in favour of the transferee and there is no ambiguity occurring in the interpretation of any statute and therefore, this ratio cannot be forcibly be infused into the transaction. For applying any ratio, it is necessary that, the circumstances must be similar to the one as was examined. It is also necessary to examine, why the conclusion was so arrived in that case.

In the case of McDowell (supra) the Andhra Pradesh Excise Duty Act contained an ambiguity as regards the liability of excise duty. The assessee interpreted that, the State would have no objection so long as the State recovered its dues and therefore, did not include the excise duty on the liquor sold by it but made the dealer to pay for the same.

This was held to be an improper and an illegitimate act because, normally, the excise duty was the liability of the manufacturer and is part of his turnover, though in the bills, this was shown separately.

This ruling can never be taken to lay down the principle that every act of reduction in taxes is illegitimate or illegal. This ruling applies only where, the application of the provisions of the Act has been thwarted. In the instant case there are no similar circumstances at all and hence this ruling would have no applicability.

In the case of M.K. Valliappan (supra) the partition of the HUF was effected before the introduction of the amendment retrospectively to the provisions of Section

171(9) of the Act, which provided for non-acceptance of partial partition of HUF's property after 31-12-1978.

The court ruled that, at the time when the partial partition was effected, the restriction did not exist, effecting of partition of property belonging to HUF was inbuilt into its structure and therefore, it could not be held to be device to avoid taxes after considering the ratio of McDowell's case. This ruling implies that, not all normal transactions are colourable even if they had been effected between related parties.

In the case of Arvind Narottam (supra), the Supreme Court examined the trust deeds of three trusts which provided that the beneficiaries would be entitled to a maximum amount of the income during the first eighteen and thirty years, as to whether the beneficiaries were entitled to the entire income of the trust and whether they could be said to have circumvented the provisions in any manner. The emphasis of the revenue was the capital value of the contingent interest must be kept in view, which would fall to the beneficiary on the expiry of the period mentioned in the trust deeds and reference was made to the observation of the apex court in McDowell & Co. Ltd.'s case (supra). The Supreme Court observed that, "It is apparent that the assessee was entitled only to the minimum prescribed in each of the deeds of settlement.

Whether or not he received any further amount out of the income of the trust fund was left entirely to the discretion of the trustees. There was no right in the assessee to any portion of the net income in excess of the minimum guaranteed to him. It is the minimum alone which he could claim as his property. So also, on the distribution of the accumulated balance as capital at the end of the stipulated period, there was no right to him to receive any part thereof. It was open to the trustees to ignore him altogether and they could pay it to such other members of the family as they chose". They had also considered the term 'property' and found that it did not extend beyond the interest to receive the minimum.

In the instant case, the appellant was entitled to receive the consideration of the sale from the transferee, which he had and in turn, he had conferred the title to the goods upon the transferee. The assessee cannot be said to hold any further interest on the shares, once they have been so transferred. The assessee cannot also be held responsible for any future income that might arise on those shares to the investment company. The assessee cannot be said to guarantee any future dividend on those shares as well. The contingent happening or arising of dividends in the future cannot be the criteria for evaluation of the present transaction and also of any benefits that might be enjoyed by the company in the future by holding to those shares. The assessee had not sold the shares with the condition that, the investment company must retain it for life. It was entirely open to the management of the investment company whether to hold those shares or sell it further. Therefore, merely because, the assessee had claimed the set off of the capital loss against the capital gain, the transaction would not become a device to avoid taxes. Simultaneously because the investment company would be entitled to claim deduction of the dividend income from its total income, cannot also be a criteria for treating the transaction as a device. If we were to accept the proposition that, reduction in the amount of taxes being as a result of allowance of deduction to be a device, and if that were to be so, then the entire Income-tax Act which allows for deductions and reliefs would become nothing but a device. Therefore, it has to be concluded that, unless the transaction is fraudulent, the benefit that might accrue to either the seller or the purchaser by the provisions of the Act, which would have the effect of reduction in taxes cannot be a device. In the instant case, the transaction of sale of shares, the claim of set off of the loss against the gain, resulting in the reduction of taxes cannot be treated as a device and accordingly the claim of the appellant for set off of brought forward long term capital loss against the long term capital gain being fully justified in the circumstances of the case, the same is upheld. The consequence issue is the inclusion of the dividend income on the shares so sold, treating the same as not a sale, being improper on the facts of the case, it is deleted.

8. The issue of levy of interest, under Sections 139(8) and 215 have been raised on the basis that, there had been no application of any mind and that, the assessee has the right to challenge the levy. Since the interests were levied without application of any mind, it is only proper that the assessing officer may allow an opportunity, for which this issue is set aside to the of the assessing officer.