

V.S.M.R. JAGDISHCHANDRAN (DEAD) BY L.Rs.

A

v.

COMMISSIONER OF INCOME TAX, MADRAS

JULY 9, 1997

[S.C. AGRAWAL AND D.P. WADHWA, JJ.]

B

*Income tax :*

*Capital Gains—Computation of—Deductions—‘Cost of acquisition’ or ‘cost of improvement’ of capital asset—Where the mortgage was created by the assessee, mortgage debt discharged by the assessee out of the sale proceeds of the encumbered immovable property—Held, not deductible from capital gains either as cost of acquisition or as cost of improvement.*

C

*Income Tax Act :*

D

*Sections 45, 48 & 256(2)—Reference—Question raised in assessee’s application—Held, Assessee’s application did not raise arguable question of law and High Court rightly rejected that application.*

The assessee sold a house, subject to encumbrance and other plots and Revenue computed the capital gains. The assessee challenged the said computation contending that the debts in respect of which the mortgage had been executed were discharged by the buyer out of the sale proceeds, and that the debts should be considered as increase in cost of acquisition of the properties and that in any event the debts may be created as improvement to the properties or as the cost of obtaining clear title to the properties. The AAC, however, upheld the contention of the assessee that there was an overriding title of the creditors in respect of the sale proceeds and there was diversion at source on the basis of such overriding title and the assessee was not liable to be charged under the capital gains in respect of the sale of properties. Tribunal held that the clearing of the mortgage debt could neither be treated as ‘cost of acquisition’ nor as ‘cost of improvement’ made by the assessee. The Tribunal, therefore, held that the deduction of the capital gains was not justified and declined to refer the question to the High Court. The assessee therefore filed an application under section 256(2) of the Act, which has been rejected by the High Court.

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**A Dismissing the appeal, this Court**

**HELD :** The assessee failed to raise any arguable question of law and the said question was rightly rejected by the High Court. [86-D]

*Ambat Echkutty Menon v. CIT, (1978) 111 ITR 880, overruled.*

**B**

*Commissioner of Income Tax v. V. Indira, (1979) 119 ITR 837 and S. Valliammai v. CIT, (1981) 127 ITR 713, referred to.*

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 4385 of 1997.

**C**

From the Judgment and Order dated 25.7.83 of the Madras High Court in T.C.P. No. 145 of 1983.

Ms Baby Krishna for the Appellant.

**D**

G.C Sharma, B.K. Prasad, B.S. Ahuja and C. Radha Krishna for the Respondent.

The Judgment of the Court was delivered by

**S. C. AGRAWAL, J.** Special leave granted.

**E**

This appeal by the assessee is directed against the order dated July 25, 1984 passed by Madras High Court in T.C. No. 145 of 1983 wherein the High Court on an application filed under Section 256(2) of the Act declined to direct the Tribunal to state a case and refer the following questions of law to the High Court :-

**F**

"1. Whether the Tribunal was right in holding that the levy of the capital gains of Rs. 68,400 is proper under the facts and circumstances of the case ?

2. Whether the Tribunal was right in holding that mortgage debts does not constitute diversion at source ?

**G**

3. Whether the debts discharged by the applicant on the properties cannot be said to enhance the cost of acquisition ?"

**H**

The assessee sold a house property No. 22, Chairman Muthurama Iyer Road, Madurai for a sum of Rs. 90,000 subject to incumbrance in the assessment year 1975-76 and for the same assessment year he sold plot Nos.

1, 3 and half of plot No. 4 in T.S. No. 831/1 for a sum of Rs. 12,600. The Income Tax Officer computed the capital gains in respect of the said properties at Rs. 68,400. The assessee questioned the computation of capital gains before the Appellate Assistant Commissioner and contended that the debts in respect of which mortgage had been executed were discharged by the buyer himself out of the sale proceeds, that the debts should be considered as increase in cost of acquisition of the properties and that in any event the debts may be treated as improvement to the property or as the cost of obtaining clear title to the property. The Appellate Assistant Commissioner rejected the said contention. He, however, upheld the contention of the assessee that there was an overriding title of the creditors in respect of the sale proceeds and, therefore, there was diversion at source on the basis of such overriding title and the assessee was not liable to charge under the capital gains in respect of the sale of the properties and, therefore, he deleted the capitals gains of Rs. 68,400 as computed by the Income Tax Officer. The Tribunal, following the decision of the Kerala High Court in *Ambat Echukutty Menon v. Commissioner of Income Tax* (1978) 111 ITR 880, and the decision of the Madras High Court in *Commissioner of Income Tax v. V. Indira* (1979) 119 ITR 837, held that clearing of the mortgage debt could neither be treated as 'cost of acquisition' nor as an 'cost of improvement' made by the assessee. The Tribunal, therefore, held that the deduction of the capital gains was not justified. Since the Tribunal declined to refer to the High Court the questions referred to - above, the assessee filed an application under Section 256(2) of the Act before the High Court which has been rejected by the impugned order. The High Court has relied upon the decision of the Full Bench of the High Court in *S. Valliammai & Anr. v. Commissioner of Income Tax*, (1981) 127 ITR 713, and has held that by discharging the mortgage debt subsisting on the property which was the subject matter of a sale, the assessee was not either improving or perfecting his title or improving the property in any manner and, therefore, the amount paid for discharging the mortgage debt cannot be taken to be for the cost of acquisition as contended by the assessee.

In Civil Appeals Nos. 6098-6101 of 1983 filed against the judgment of the Full Bench of the Madras High Court in *S. Valliammai & Anr. v. Commissioner of Income Tax*, (supra) we have examined the correctness of the view of the Kerala High Court in *Ambat Echukutty Menon v. Commissioner of Income Tax*, (supra) and have held that the said decision

- A does not lay down the correct law in so far as it holds that where the previous owner had mortgaged the property during his life time the clearing off the mortgage debt by his successor can neither be treated as 'cost of acquisition' nor as 'cost of improvement' made by the assessee. It has been held that where a mortgage was created by the previous owner during his time and the same was subsisting on the date of his death, the successor obtains only the mortgagor's interest in the property and by discharging the mortgage debt he acquires the mortgage's interest in the property and, therefore, the amount paid to clear off the mortgage is the cost of acquisition of the mortgage's interest in the property which is deductible as cost of acquisition under Section 48 of the Act. In the present case, we find that
- C the mortgage was cleared by the assessee himself. It is not a case where the property had been mortgaged by the previous owner and the assessee had acquired only the mortgagor's interest in the property mortgaged and by clearing the same he had acquired the interest of the mortgage in the said property. The questions raised by the assessee in the application submitted under Section 256(2) of the Act do not, therefore, raise any
- D arguable question of law and the said application was rightly rejected by the High Court. In the circumstances, even though we are unable to agree with the reasons given in the impugned order, we are in the agreement with the order of the High Court dismissing the application filed by the assessee under Section 256(2) of the Act.

E

The appeal is, therefore, dismissed. No order as to costs.

R.K.S.

Appeal dismissed.