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M.CT.M. CHIDAMBARAM CHETTIAR

v.

COMMISSIONER OF INCOME-TAX, MADRAS

November 29, 1965

B [K. SUBBA RAO, J. C. SHAH AND S. M. SIKRI, JJ.]

Indian Income-tax Act, 1922 (*Act* 11 *of* 1922), *s.* 44*D—Firm transferred assets to Non-resident—Income from Non-resident—If partners of firm assessable separately.*

A firm, constituted by the assessees who were closely related, transC ferred assets to a Corporation carrying on money-lending business in the Federated Malaya States. In consideration of the assets so transferred the Corporation allotted shares to the partners of the firm. The Income-tax Officer assessed the partners of the firm separately under s. 44D of the Act in respect of the income of the Corporation, which on appeals were upheld by the Appellate Assistant Commissioner. On further appeals by the assessees, the Tribunal allowed the appeals on the ground that the income from the assets transferred was not assessable to tax at D the time of transfer. At the instance of the Revenue, the question was referred to the High Court which was answered against the assessee. In appeal to this Court :

HELD : The High Court was correct in answering the question against the assessee.

(i) The language of s. 44D(1) of the Act is plain. It does not say E "when any person has transferred any assets" but it says, "by means of a transfer of assets". The person who transfers assets is not designated but emphasis is laid on the consequence flowing from such a transfer. Whosoever effects the transfer, if by such a transfer the assessee acquires a right to enjoy the income, he is liable to tax. The words "means" and "acquired" in the context, are only words of passive nature. The hand that transfers is immaterial; what matters is the result envisaged by the said section, namely a non-resident is the transferee of the assets, F but the assessee acquires the power to enjoy the income from those assets. The words "by means of a transfer of assets" mean nothing more than "as a result or by virtue or in consequence of the transfer". [765 E-G; 766 E]

Congreve and Congreve v. *Commissioner of Inland Revenue,* (1943-'49) 30 T.C. 163 and *Bambrdige* v. *Commissioner of Inland Revenue,* (1953-'56) 36 T.C. 313, applied.

G (ii) The construction that s. 44D(1) can be invoked only if at the time of the transfer the income from the said assets was liable to tax, is not only inconsistent with the phraseology used but will defeat the object of the section. The expressions "any income", "such income" and "that income" found in the sub-section refer to the same income. What is assessed in a particular year is that income which is deemed to be the income in the hands of assessee. "That income" is such income in re-H gard whereof he has "the power to enjoy". "Such income" is any income which if it were the income of the assessee would be chargeable to income-tax. The quality of chargeability is referable only to the income from the assets transferred during the year in which it is sought to be assessed. [766 F; 767 B]

(iii) If the assessees were able directly or indirectly to control the income of the Corporation, they would be deemed to have the power to enjoy the income. Sub-section (5) of s. 44D gives an enlarged meaning to the words "power to enjoy" in sub-s. (1).

In the present case, the circumstances were overwhelming to establish that the assessees had a controlling voice in the affairs of the Corporation. They were closely related, holding almost all the shares of the Corporation, and were the partners of the firm which transferred the assets. [767 H; 768 B-C]

(iv) The burden was upon the assesee to show to the satisfaction of the Income-tax Officer that the transfer was saved under sub-section (3) of s. 44D inasmuch as it was not for a purpose to avoid tax liability but was only a *bona fide* commercial transaction. The Tribunal found as a fact on the material placed before it that the transfer was to avoid the liability to taxation; and that being a finding of fact, the High Court rightly accepted it. The correctness of the said finding of fact cannot be permitted to be canvassed in these appeals. [768 G-769 A]

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 477 to 488 of 1964.

Appeals from the judgment and order dated October 16, 1959 of the Madras High Court in Case Referred No. 31 of 1954.

N. A. Palkhivala, C. Ramakrishna, O. C. Mathur and *J. B. Dadachanji* for the appellants.

A. V. Viswanatha Sastri, Gopal Singh, R. N. Sachthey and *B. R. G. K. Achar,* for the respondent.

The Judgment of the Court was delivered by

Subba Rao, J. These appeals raise the question of the liability of the appellants to pay income-tax under s. 44D (1) of the Indian Income-tax Act, 1922, hereinafter called the Act, in respect of the income of the M.C.T.M. Banking Corporation Limited.

Sir M.Ct.M. Muthiah Chettiar, his wife Deivanai Achi, his two sons Chidambaram Chettiar and Muthiah Chettiar, and his two daughters Umayal Achi and Vallia Murai Achi constituted an undivided Hindu family. The said family carried on money-lending business on an extensive scale in British India, Burma and elsewhere. Upto and inclusive of the year 1927-28, the undivided Hindu family was assessed to income-tax as such. During the assessment year 1928-29 it was claimed that a partition had taken place in the said family and that Sir M.Ct.M. Muthiah Chettiar and his two sons constituted a firm. The said firm was duly registered and it was assessed to income-tax. After the death of the said Sir M.Ct.M. Muthiah Chettiar in 1929, his two sons and his wife continued the firm and it was assessed to income-tax as a firm. In June 1929 the said firm started a new

A money-lending business at Kuala Lumpur in the Federated Malaya States with a capital of Rs. 12 lakhs. The said capital was transferred from its business in Burma. On March 24, 1932, a company called the M.Ct.M. Banking Corporation, hereinafter called the Corporation, was incorporated in Pudukkotai. It commenced business on and from March 31, 1932. One of the B purposes of the said Corporation was to acquire and carry on business which was being carried on by the firm in Kuala Lumpur. A branch of the Corporation was opened in Kuala Lumpur on September 22, 1933. Between November 1, 1933, and November 31, 1937. On December 31, 1938, out of the total shares were transferred to the Corporation and in consideration of the C assets so transferred, the Corporation allotted to the partners of the firm 1,200 shares of face value of Rs. 1,000 each. Though the Corporation commenced business in 1932, no dividends were declared by it. But in 1938 the Corporation distributed bonus shares of value of Rs. 5 lakhs out of the profits of Rs. 5,04,084 which had become accumulated in the Corporation up to Decem- D ber 31, 1937. On December 31, 1938, out of the total shares of 2,271 in the Corporation, the said two sons and the widow of Sir M.Ct.M. Muthiah Chettiar held 1,944 shares. From the assessment year 1933-34 to the assessment year 1938-39 the firm was treated as the agent of the Corporation and its income arising and accruing in British India was assessed in the hands of the firm E which had its head office in Madras. For the assessment years 1939-40, 1940-41 and 1941-42, the Income-tax Officer, I Circle, Madras, assessed the said partners of the firm separately under s. 44D of the Act in respect of the income of the Corporation. Against the orders of the Income-tax Officer, the three partners F preferred appeals to the Appellate Assistant Commissioner, who rejected the same. Against the Orders of the Appellate Assistant Commissioner rejecting the appeals the assessees preferred appeals to the Income-tax Appellate Tribunal, Madras, Bench 'A'. The Tribunal allowed the appeals of the assessees on the ground that the income from the assets transferred to the Corporation was G not assessable to income-tax at the time of the transfer and that, therefore, the income therefrom was not liable to tax during the assessment years under s. 44D of the Act. At the instance of the Revenue, the following question of law was referred to the High Court of Madras for its opinion :

H "Whether the income made by the Corporation can be assessed under the provisions of Section 44-D of the Income-tax Act in the hands of the present assessees and if so, to what extent."

A Division Bench of the High Court, by its judgment, dated August 4, 1958, held that the said income of the Corporation was attracted by s. 44D of the Act, but before giving a final answer to the question propounded, it directed the Tribunal to furnish a further statement of case on the question whether the assessees were entitled to relief under sub-s. (3)(a) of s. 44D of the Act. On December 23, 1958, the Tribunal submitted a finding that the assessees did not satisfy the requirements of the said sub-section. The High Court accepted the said finding and answered the question against the assessees in the affirmative. The present appeals were filed against the order of the High Court after obtaining a certificate from the said High Court.

We shall now proceed to consider the arguments advanced by Mr. Palkhivala, learned counsel for the assessees, in support of his contention that the income of the Corporation was not assessable to tax in the hands of the assessees. As all his arguments turned upon the provisions of s. 44D of the Act, it would be convenient to read the same at the outset :

> "Where any person has, by means of a transfer of assets, by virtue or in consequence whereof, either alone or in conjunction with associated operations, any income which if it were the income of such person would be chargeable to income-tax becomes payable to a person not resident or to a person resident but not ordinarily resident in the taxable territories, acquired any rights by virtue or in consequence of which he has within the meaning of this section power to enjoy such income, whether forthwith or in the future, that income shall, whether it would or would not have been chargeable to income-tax apart from the provisions of this section, be deemed to be income of such first mentioned person for all purposes of this Act."

Chapter VB was inserted in the Income-tax Act, 1922, by the Indian Income-tax (Amendment) Act, 1939 (Act VII of 1939). Section 44D is one of the sections of that Chapter. The provisions of this Chapter were modelled on s. 18 of the English Finance Act of 1936, as amended by s. 28 of the English Finance Act of 1938. The object of s. 44D of the Act, as disclosed by the provisions thereof, was to prevent residents of India from evading the payment of income-tax by transferring their assets to non-residents while enjoying the income by adopting devious methods. The sub-section suffers from want of clarity, but a deeper scrutiny brings out the following ingredients of it :

A (i) there must be a transfer of assets; (ii) by reason of that transfer, income traceable to the said assets becomes payable to a person non-resident or to a person resident but not ordinarily resident in the taxable territories; (iii) the resident by means of the transfer alone or in conjunction with associated operations, acquires right to enjoy such income; (iv) the income from the said assets, B if it was the income of the resident, would be chargeable to income-tax; and (v) in that event, the income of the non-resident would be deemed to be the income of the resident for all the purposes of the Act. Shortly stated, under this section, if a resident has power to enjoy the income accruing or arising out of the assets transferred to a non-resident, he would be deemed to have C received that income and, therefore, would be liable to be assessed under the Act.

The first contention of Mr. Palkhivala is that the expression "by means of a transfer" in s. 44D(1) of the Act means a transfer by an assessee and that, as in the instant case the transfer was D by the firm which was a juristic entity separate from the assessees, the income of the Corporation was not assessable to tax in their hands.

The language of the sub-section is plain. It does not say "when any person has transferred any assets", but it says, "by means of a transfer of assets". The person who transfers assets E is not designated but emphasis is laid on the consequences flowing from such a transfer. Whosoever effects the transfer, if by such a transfer the assessee acquires a right to enjoy the income, he is liable to tax. The words "means" and "acquired" in the context are only words of passive nature. The hand that transfers F is immaterial: what matters is the result envisaged by the said section, namely, a non-resident is the transferee of the assets but the assessee acquires the power to enjoy the income from those assets. This construction is supported by the decisions of English Courts given on a section which is in *pari materia* with the relevant part of s. 44D(i) of the Act. The material part of s. 18 G of the English Finance Act, 1936, as amended by s. 28 of the English Finance Act, 1938, reads:

> (1) Where such an individual has by means of any such transfer, either alone or in conjunction with associated operations, acquired any rights by virtue of which he has, within the meaning of this section, power to H enjoy, whether forthwith or in the future, any income of a person resident or domiciled out of the United Kingdom which, if it were income of that individual

> received by him in the United Kingdom, would be chargeable to income-tax by deduction or otherwise, that income shall, whether it would or would not have been chargeable to income-tax apart from the provisions of this section, be deemed to be income of that individual for all the purposes of the Income-tax Acts.

It would be noticed that in the said sub-section, as in s. 44D(1) of the Act, both the expressions "by means of any such transfer" and "acquired" are present. In *Congreve and Congreve* v. *Commissioners of Inland Revenue*(1), Lord Simonds, repelling the argument similar to that presented to us, observed :

> ".....it is to my mind clear, first, that in their ordinary grammatical sense the words "by means of" do not connote any personal activity on the part of the person who is said to enjoy or suffer something by those means, and, secondly, that in their present context it is not necessary or legitimate in order to give a limiting sense to the words to read them as if they were followed by such word as "effected by him"."

This view was followed by Harmam, J., in *Bombridge* v. *Commissioners of Inland Revenue*(2). The words "by means of a transfer of assets" mean nothing more than "as a result or by virtue or in consequence of the transfer". We, therefore, reject the first contention of the learned counsel.

The second contention is that the said sub-section can be invoked only if at the time of the transfer the income from the said assets was liable to tax and that, as in the present case when the transfer of the assets was effected in 1933 the income therefrom was not chargeable to income-tax—for it was foreign income not remitted to India—the said assets fell outside the ken of the said sub-section. This argument was sought to be sustained on the express terms of s. 44D(1) of the Act. The clause "any income which if it were the income of such person would be chargeable to income-tax", it is said, is descriptive of the assets transferred and constitutes a limitation on the operation of the section. This construction is not only inconsistent with the phraseology used but will defeat the object of the section. The expressions "any income", "such income" and "that income" found in the sub-section refer to the same income. What is assessed in a particular year is that income which is deemed to be the income in the hands of the assessee. "That income" is such income in regard whereof he has "the power to enjoy".

(1) (1943-'49) 30 T.C. 163. (2) (1963-'56) 36 T.C. 313.

A "Such income" is any income which if it were the income of the assessee would be chargeable to income-tax. The quality of chargeability is referable only to the income from the assets transferred during the year in which it is sought to be assessed. As Balakrishna Ayyar, J., pointed out in the judgment under appeal, to accede to the argument of the assessee, the words in B s. 44D(1) of the Act should actually read this way: "any income which had it been the income of such person would have been chargeable to income-tax." But the words read otherwise thus: "any income which if it were the income of such person would be chargeable to income-tax". The tense refers to the assessment year and not to the year when the transfer was affected. C Learned counsel for the assessees contended that this construction would affect adversely a *bona fide* transferor of assets who could not possibly have anticipated that the income from such assets would be chargeable to tax in future and that that could not have been the intention of the Legislature. As indicated earlier, the sub-section is not concerned with the transferor but only with D the result brought about by means of the transfer of the assets in conjunction with associated operations. The sub-section was designedly couched in the widest phraseology to prevent evasion of tax in the manner prescribed thereunder. If it was not so, a person can transfer his assets to another in a year they have E not yielded any income at all, reserving indirectly the right to enjoy the income therefrom in future or he may transfer his assets when they are not yielding any income, but which may, under a scheme of future development, yield enormous profits. On the other hand, a *bona fide* transferor is amply protected by sub-s. (3) of s. 44D of the Act. We, therefore, find no merits F in this contention either.

The next submission of the learned counsel for the assessees is that the assessees had not acquired, by means of the said transfer of assets to the Corporation or in consequence thereof, any power to enjoy the income therefrom within the meaning of s. 44D(1) of the Act. While conceding that, if the G assessees had the controlling share in the corporation, they would have the power to enjoy its income, it was said that there was no evidence on which it could be held that the assessees, though closely related, were acting in unison and were controlling the affairs of the Corporation. Sub-section (5) of s. 44D gives an enlarged meaning to the words "power to enjoy" in sub-s. (1). H The relevant clause of that sub-section is cl. (e), which reads:

> (5) A person shall, for the purposes of this section, be deemed to have power to enjoy income of a person

not resident, or resident but not ordinarily resident, in the taxable territories, if— A

> (e) such first-mentioned person is able, in any manner whatsoever and whether directly or indirectly, to control the application of the income.

If the assessees were able directly or indirectly to control the income of the Corporation, they would be deemed to have the power to enjoy its income. In the present case, the circumstances are overwhelming to establish that the assessees had a controlling voice in the affairs of the Corporation. They are closely related: two of them are brothers and the third is their mother. They were the partners of the firm which transferred the assets. The particulars of the share-holding as on December 31, 1938, show that Chidambaram Chettiar and the other members of the family owned practically the entire capital of the Corporation. The three partners owned 1944 shares out of 2,271 shares of the Corporation and the balance was held by their close relatives. Apart from the three partners, the other shareholders were the son, sisters and the wife of Chidambaram Chettiar. It is obvious that the Corporation was a close one and the partners of the firm had the controlling voice in the management of the affairs of the Corporation. The argument that there is no evidence that there was unity of interest among the partners ignores the realities of the situation, for the history of the firm, the constitution of the Corporation, the manner the assets were transferred and the other circumstances brought out in the record lead to the only inference that the partners were acting in unison throughout. Indeed it is recorded in the statement of case that it was conceded before the Tribunal that the assessees had power to enjoy the income of the assets transferred within the meaning of s. 44D(1) of the Act. In the circumstances, the High Court rightly held that the assessees had the power to enjoy the income within the meaning of s. 44D(1) of the Act. B C D E F

Lastly it was contended that the income in question was saved from the operation of sub-s. (1) of s. 44D of the Act by sub-s. (3) thereof. To state it differently, the transfer of the assets to the Corporation was not for a purpose to avoid the tax liability but was only a *bona fide* commercial transaction. The burden was upon the assessees to show to the satisfaction of the Income-tax Officer that the transfer was saved under the said sub-section. The Tribunal found as a fact on the material placed before it that the transfer was to avoid the liability to taxation; and that being a finding of fact, the High Court rightly accepted G H

A it. The correctness of the said finding of fact cannot be permitted to be canvassed in these appeals.

In the result, we hold that the High Court has answered the question correctly. The appeals fail and are dismissed with costs. One hearing fee.

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Appeal dismissed.