***** **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ ITA No.116/2011

**%** **Date of Decision** : 13th February, 2012.

ARUN SHUNGLOO TRUST ..... Appellant
Through: Mr.S.Krishanan, Advocate

versus

CIT ..... Respondent
Through: Mr.Kamal Sawhney,Advocate

**CORAM:**
**HON'BLE MR. JUSTICE SANJIV KHANNA**
**HON'BLE MR. JUSTICE R.V. EASWAR**

**SANJIV KHANNA,J: (ORAL)**

By the order dated 2nd August, 2011, the following substantial question of law was framed.

> *"Whether Explanation (iii) to Section 48 of the Act can be interpreted without considering the effect of Section 49(1) Explanation and Explanation 1(i)(b) of Section 2 (42A), when all three sections relate to the same subject matter of computation of capital gains on the sale of a capital asset, description of the previous owner and the period of holding of the asset by the assessee."*

2. We have heard the counsel for the parties and thus, proceed to pronounce our decision on the aforesaid substantial question of law.

3. Facts are undisputed and may be noticed.

4. One Mr.Arun Shungloo acquired property No.D-11, Maharani Bagh, New Delhi, sometime before 1st April, 1981. On 5th January, 1996, Mr.Arun Shungloo transferred the property to the trust managed by the appellant, i.e., Arun Shungloo Trust.

5. During the period relevant to the assessment year 2001-02, the appellant Trust sold and transferred the acquired property to a third party. The substantial question of law mentioned above relates to the computation of long term capital gains. The contention of the Revenue which has been accepted by the Tribunal is that appellant is entitled to indexed cost of acquisition for the period on or after 5th January, 1996, i.e., the date on which the appellant-Trust had acquired the property upto the date of sale. The contention of the appellant assessee is that it is entitled to the benefit of indexed cost of acquisition from 1.4.1981, i.e. for the period during which Mr. Arun Shungloo also held the property before it was transferred to the appellant-Trust on 5.1.1996.

6. In order to appreciate the controversy, the provisions of Section 45, 48 and 49 of the Income Tax Act, 1961 ('Act', for short) may be noticed. The relevant portions of the said sections read as under:-

> *"**Section 45**:(1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 54, 54B, 54D, 54E, 54EA, 54EB, 54F, 54G and 54H, be chargeable to income-tax under the head "Capital gains", and shall be deemed to be the income of the previous year in which the transfer took place.*
>
> *……..*

*…….*

***Section 48:*** *The income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely :-*

*(i) Expenditure incurred wholly and exclusively in connection with such transfer;*

*(ii) The cost of acquisition of the asset and the cost of any improvement thereto:*

***Provided*** *that in the case of an assessee, who is a non-resident, capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as was initially utilised in the purchase of the shares or debentures, and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so however, that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every reinvestment thereafter in, and sale of, shares in, or debentures of, an Indian company :*

***Provided further*** *that where long-term capital gain arises from the transfer of a long-term capital asset, other than capital gain arising to a non-resident from*

*the transfer of shares in, or debentures of, an Indian company referred to in the first proviso, the provisions of clause (ii) shall have effect as if for the words "cost of acquisition" and "cost of any improvement", the words "indexed cost of acquisition" and "indexed cost of any improvement" had respectively been substituted.*

*Explanation : For the purposes of this section, --*

*(i) ……..;*

*(ii) ……..;*

*(iii) "Indexed cost of acquisition" means an amount which bears to the cost of acquisition the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 1st day of April, 1981, whichever is later;*

*(iv) "Indexed cost of any improvement" means an amount which bears to the cost of improvement the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset took place;*

*(v)…….*

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***Section 49*** *(1) Where the capital asset became the property of the assessee - (i) On any distribution of assets on the total or partial partition of a Hindu undivided family;*

*(ii) Under a gift or will;*

*(iii) (a) By succession, inheritance or devolution, or*

*(b) On any distribution of assets on the dissolution of a firm, body of individuals, or other association of persons, where such dissolution had taken place at any time before the 1st day of April, 1987,*

*(c) On any distribution of assets on the liquidation of a company, or*

*(d) Under a transfer to a revocable or an irrevocable trust, or*

*(e) Under any such transfer as is referred to in clause (iv) [or clause (v)] [or clause (vi)] [or clause (via)] [or clause (viaa)] [or caluse (vica)] or [clause (vicb)] or clause (xiiib) of section 47];*

*[ (iv) Such assessee being a Hindu undivided family, by the mode referred to in sub-section (2) of section 64 at any time after the 31st day of December, 1969,]*

*the cost of the acquisition of the assets shall be deemed to be the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be.*

*[ Explanation : In this [sub-section] the expression "previous owner of the property" in relation to any capital asset owned by an assessee means the last previous owner of the capital asset who acquired it by*

*a mode of acquisition other than that referred to in clause (i) or clause (ii) or clause (iii) [or clause (iv)] of this [sub-section].]*

*....*
*....."*

8. Section 45 of the Act stipulates that profits and gains arising from transfer of a capital asset affected in the previous year is chargeable to income tax under the heading "Capital gains" and shall be deemed to be the income of the previous year in which the said transfer took place. This is the charging section. Sections 48 and 49 prescribe the mode of computation and cost of acquisition, improvement normally and with reference to certain modes of acquisition and indexation of the cost of acquisition/ improvement.

9. Section 48 of the Act stipulates that while computing capital gains, the cost of acquisition of an asset and the cost of improvement thereto, has to be deducted from the full value of the consideration received or accruing as a result of the transfer of the capital asset. The second proviso to Section 48 stipulates that the expression "cost of acquisition" and "cost of improvement" shall mean "indexed cost of acquisition" and "indexed cost of improvement" in case of long term capital gains (except in case of sale of shares, etc. by a non-resident).

10. Section 49 of the Act stipulates that in case of acquisition of a capital asset under gift or will, by succession, inheritance or devolution, creation of trust, etc., the cost of acquisition shall be deemed to be the cost

at which the previous owner of the property has acquired the capital asset as increased by the cost of improvement, if any, of the assets, as may be incurred or borne by the previous owner or the assessee, as the case may be. Thus, as per Section 49, the cost of acquisition in the hands of an assessee is treated as the cost of acquisition by the previous owner. Similar benefit/ advantage is given in respect of cost of improvement. Sections 48 and 49 have to be read harmoniously to give full effect to the legislative intent.

11. This brings us to the Explanation to Section 48 which defines, for the purpose of the said Section, the "indexed cost of acquisition" and "indexed of any improvement".

12. Learned counsel for the Revenue has emphasized and submitted that in Clause (iii) of Explanation to Section 48, indexed cost of acquisition has to be computed from the first year in which the capital asset was held by the assessee. He states and submits that the scope of the term "income" has been widened to bring capital gains to tax. It is, accordingly, submitted that the word/expression "held by the assessee" used in Clause (iii) of Explanation refers to the "first year in which the asset was held by the assessee" and not the date on which the previous owner had acquired the capital asset. The legislature has deliberately withheld benefit/ advantage mentioned in Section 49. He submits that Section 49 has a limited application, as it only makes reference to the computation of cost of acquisition and the same cannot be taken into account for computing "indexed cost of acquisition", a specific expression

defined and used in Section 48.

13. We find it difficult to accept the said contention. Section 48 uses two expressions "cost of acquisition" and "cost of any improvement". The second proviso states that the said expressions will mean "indexed cost of acquisition" and "indexed cost of any improvement" in all cases of long term capital gains except in case of sale of shares, debentures, etc. by a non-resident. As far as "indexed cost of improvement" is concerned, it is stipulated in clasue (iv) to the Explanation that the cost of improvement would be in the same proportion, as to the cost inflation index for the year in which the capital asset was transferred bears to the cost inflation index for the year in which the improvement of the capital asset took place. Clause (iv) of the Explanation to Section 48 does not refer to the date on which the asset was held by the assessee. On reading of Clause (iv) of Explanation to Section 48 of the Act, it is apparent that the term "cost of improvement' would include the cost of improvement(s) made by the previous owner. The benefit of indexed cost of improvement would be available even if the capital asset is acquired by the assessee under any gift, will or succession, trust etc. and improvement was made by the previous owner.

14. If the contention of the Revenue is accepted, then benefit of indexed cost of acquisition, will not available to an assessee in a case covered by Section 49 from the date on which the asset was held by the previous owner but only from the date the capital asset was transferred to the assessee. This will lead to a disconnect and contradiction between

"indexed cost of acquisition" and "indexed cost of improvement" in the case of capital assets where Section 49 applies. This cannot be the intention behind the enactment of Section 49 and its Explanation to Section 48. There is no reason or ground why the legislative would want to deny or deprive an assessee benefit/advantage of the previous holding for computing "indexed cost of acquisition" while allowing the said benefit for computing "indexed cost of improvement".

15. Normally literal rule of construction is applied and the words of the statute are to be understood in their ordinary and popular sense, but this is subject to the rider that this should not lead to absurdity, contradiction or stultification of the statutory objective. Literal construction should be avoided, if it leads to unwarranted repugnances or inconsistencies. In such circumstances the expression/words can be interpreted by the courts to avoid absurdities and inconsistencies between the provisions. In the present case, as noticed above, the construction placed by the Revenue will lead to inconsistency and incongruities, when we refer to Section 49 and clause (iv) to Explanation (1) to Section 48. This will result in absurdities because the holding of predecessor has to be accounted for the purpose of computing the cost of acquisition, cost of improvement and indexed cost of improvement but as per the Revenue not for the purpose of indexed cost of acquisition. As noticed below, even for the purpose of deciding whether the transaction is a short term capital gain or long term capital gain, the holding by the predecessor is to be taken into consideration.

16. Benefit of indexed cost of inflation is given to ensure that the taxpayer pays capital gain tax on the "real" or actual 'gain' and not on the increase in the capital value of the property due to inflation. This is the object or purpose in allowing benefit of indexed cost of improvement, even if the improvement was by the previous owner in cases covered by Section 49. Accordingly there is no justification or reason to not allow the benefit of indexation to the cost of acquisition in cases covered by Section 49. This is not the legislative intent behind clause (iii) to Explanation to Section 48 of the Act.

17. There is no reason and justification to hold that clause (iii) of the Explanation intents to reduce or restrict the "indexed cost of acquisition" to the period during which the assessee has held the property and not the period during which the property was held by the previous owner. The interpretation relied by the assessee is reasonable and in consonance with the object and purpose behind Sections 48 and 49 of the Act.

18. The expression "held by the assessee" used in Explanation (iii) to Section 48 has to be understood in the context and harmoniously with other Sections. The cost of acquisition stipulated in Section 49 means the cost for which the previous owner had acquired the property. The term "held by the assessee" should be interpreted to include the period during which the property was held by the previous owner.

19. We may notice that the term "held by the assessee" has been defined in Explanation 1(i)(b) to Section 2(42A) of the Act. Section 2(42A) defines the expression "short term capital gains". The said

Explanation provides as under:-

> *"[Explanation1].— (i) In determining the period for which any capital asset is held by the assessee—*
> *(a) ……*
> *(b) in the case of a capital asset which becomes the property of the assessee in the circumstances mentioned in [sub-section(1) ] of section 49, there shall be included the period for which the asset was held by the previous owner referred to in the said section."*

20. Clause (iii) to Explanation to Section 48 is applicable when the transfer is a long term capital gain and not a short term capital gains. The legislature was conscious of definition of the expression "held by the assessee" in Explanation 1(i)(b) of Section 2(42A) and, therefore, has used the same expression in Explanation (iii) to Section 48 of the Act. The aforesaid Explanation to Section 2(42A) was referred to by the Bombay High Court in ***CIT v. Manjula J.Shah (Mumbai)***, (2011) 16 Taxman 42 (Bom), wherein a similar controversy/question was examined and it was held as under:

> *"17. We see no merit in the above contention. As rightly contended by Mr. Rai, learned counsel for the assessee, the indexed cost of acquisition has to be determined with reference to the cost inflation index for the first year in which the capital asset was 'held by the assessee'. Since the expression 'held by the assessee' is not defined under Section 48 of the Act, that expression has to be understood as defined under Section 2 of the Act. Explanation 1(i)(b) to Section 2*

*(42A) of the Act provides that in determining the period for which an asset is held by an assessee under a gift, the period for which the said asset was held by the previous owner shall be included. As the previous owner held the capital asset from 29/1/1993, as per Explanation 1(i)(b) to Section 2(42A) of the Act, the assessee is deemed to have held the capital asset from 29/1/1993. By reason of the deemed holding of the asset from 29/1/1993, the assessee is deemed to have held the asset as a long term capital asset. If the long term capital gains liability has to be computed under Section 48 of the Act by treating that the assessee held the capital asset from 29/1/1993, then, naturally in determining the indexed cost of acquisition under Section 48 of the Act, the assessee must be treated to have held the asset from 29/1/1993 and accordingly the cost inflation index for 1992-93 would be applicable in determining the indexed cost of acquisition.*

*18. If the argument of the revenue that the deeming fiction contained in Explanation 1(i)(b) to Section 2(42A) of the Act cannot be applied in computing the capital gains under Section 48 of the Act is accepted, then, the assessee would not be liable for long term capital gains tax, because, it is only by applying the deemed fiction contained in Explanation 1(i)(b) to Section 2 (42A) and Section 49(1)(ii) of the Act, the assessee is deemed to have held the asset from 29/1/1993 and deemd to have incurred the cost of acquisition and accordingly made liable for the long*

*term capital gains tax. Therefore, when the legislature by introducing the deeming fiction seeks to tax the gains arising on transfer of a capital asset acquired under a gift or will and the capital gains under Section 48 of the Act has to be computed by applying the deemed fiction, it is not possible to accept the contention of revenue that the fiction contained in Explanation 1(i)(b) to Section 2(42A) of the Act cannot be applied in determining the indexed cost of acquisition under Section 48 of the Act.*

*19. It is true that the words of a statute are to be understood in their natural and ordinary sense unless the object of the statute suggests to the contrary. Thus, in construing the words 'asset was held by the assessee' in clause (iii) of Explanation to Section 48 of the Act, one has to see the object with which the said words are used in the statute. If one reads Explanation 1(i)(b) to Section 2(42A) together with Section 48 and 49 of the Act, it becomes absolutely clear that the object of the statute is not merely to tax the capital gains arising on transfer of a capital asset acquired by an assessee by incurring the cost of acquisition, but also to tax the gains arising on transfer of a capital asset inter alia acquired by an assessee under a gift or will as provided under Section 49 of the Act where the assessee is deemed to have incurred the cost of acquisition. Therefore, if the object of the legislature is to tax the gains arising on transfer of a capital acquired under a gift or will by including the period for which the said asset was*

*held by the assessee, then that object cannot be defeated by excluding the period for which the said asset was held by the previous owner in determining the period for which the said asset was held by the assessee, then that object cannot be defeated by excluding the period for which the said asset was held by the previous owner while determining the indexed cost of acquisition of that asset to the assessee. In other words, in the absence of any indication in clause (iii) of the Explanation to Section 48 of the Act that the words 'asset was held by the assessee' has to be construed differently, the said words should be construed in accordance with the object of the statute, that is, in the manner set out in Explanation 1(i)(b) to section 2(42A) of the Act.*

*20. To accept the contention of the revenue that the words used in clause (iii) of the Explanation to Section 48 of the Act has to be read by ignoring the provisions contained in Section 2 of the Act runs counter to the entire scheme of the Act. Section 2 of the Act expressly provides that unless the context otherwise requires, the provisions of the Act have to be construed as provided under Section 2 of the Act. In Section 48 of the Act, the expression 'asset held by the assessee' is not defined and, therefore, in the absence of any intention to the contrary the expression 'asset held by the assessee' in clause (iii) of the Explanation to Section 48 of the Act has to be construed in consonance with the meaning given in Section 2(42A) of the Act. If the meaning given in*

> *Section 2(42A) is not adopted in construing the words used in Section 48 of the Act, then the gains arising on transfer of a capital asset acquired under a gift or will be outside the purview of the capital gains tax which is not intended by the legislature. Therefore, the argument of the revenue which runs counter to the legislative intent cannot be accepted.*"

21. We are entirely in agreement with the findings/ ratio recorded by the Bombay High Court in the case of ***Manjula J. Shah*** (supra).

22. In view of the aforesaid discussion, the question of law is hereby answered in negative and in favour of the appellant-assessee and against the respondent-Revenue. No costs.

**SANJIV KHANNA, J.**

**R.V. EASWAR, J.**

**FEBRUARY 13, 2012**
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