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

\+ **INCOME TAX APPEAL No. 600/2004**

Reserved on: 13th December, 2017
% **Date of Decision**: 20th April, 2018

KAUSHALYA DEVI (DECEASED) THROUGH LEGAL REPRESENTATIVES ..... Appellant
Through Mr. Prakash Kumar and Ms. Rashmi Singh, Advocates.

versus

COMMISSIONER OF INCOME TAX ..... Respondent
Through Mr. Asheesh Jain, Senior Standing Counsel.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MS. JUSTICE PRATHIBA M. SINGH

SANJIV KHANNA, J.

This appeal under Section 260A of the Income Tax Act, 1961 (Act, for short) by Kaushalya Devi, since deceased and now represented by her legal representative, relates to assessment year 1994-95 and arises from the order of the Income Tax Appellate Tribunal ('Tribunal' for short) dated 5th May, 2004 in ITA No.6259/Del of 1997 and ITA No. 826/Del of 1998.

2. The appeal was admitted for hearing vide order dated 18th October, 2005, on the following substantial question of law:-

> "Whether ITAT was, on a true and proper interpretation of Section 48 (i) of the Income Tax Act, 1961, correct in holding that the expenditure of Rs.25,00,000/- incurred by the assessee by way of liquidated damages paid to the first purchaser was not incurred in connection with the transfer of the property and could not therefore be deducted from the sale consideration for computing the long term gain?"

We feel that the aforesaid question of law as framed requires a slight modification and should read as under:-

> "Whether the ITAT, on true and proper interpretation of Section 48 (i) of the Income Tax Act, 1961, was correct in holding that the amount of Rs. 25,00,000/- paid by the assessee to Anil Kumar Sharma for non-fulfillment of first agreement to sell was not incurred in connection with the transfer of property and, therefore, could not be deducted from the sale consideration for computing long term capital gains?"

3. The appellant, an individual and herein after referred to as the assessee, in her return of income for the assessment year 1994-95 had declared long term capital gains of Rs.5,42,000/- from sale of immovable property No.80, Adhchini, New Delhi (the property, for short). The assessee had purchased the property on 1st August, 1971 for Rs.30,000/-. The property was sold by a tripartite agreement to sell dated 4th November, 1993 amongst the purchaser who had paid Rs.45,00,000/- to the tenant to vacate the property and transfer possession, and Rs.55,00,000/- to the assessee for transfer of title and ownership rights in the property. Rs.55,00,000/- received by the assessee was treated as the sale consideration

for transferring the property. To this extent there is no lis and dispute between the assessee and the Revenue.

4. The dispute relates to deduction of Rs.25,00,000/- paid by the assessee to Anil Kumar Sharma, with whom the assessee had entered into an earlier agreement to sell dated 10th April, 1989 for sale of the property for Rs. 15,00,000/-. Under the said agreement, the assessee had received Rs.7,50,000/- as advance and part payment from Anil Kumar Sharma. As per the agreement to sell and mutual agreement the assessee had paid Rs.25,00,000/- on 16th December,1993 to Anil Kumar Sharma for foregoing his right and claim under the agreement dated 10th April, 1989. Rs. 7,50,000/- was refunded by the purchaser by cheque to Anil Kumar Sharma and reduced from payment of Rs.55,00,000/- to be paid to the assessee.

5. The assessee had treated the payment of Rs.25,00,000/- to Anil Kumar Sharma as expenditure incurred wholly and exclusively in connection with transfer under Section 48 (i) of the Act. In the alternative, it was submitted that the expenditure was incurred for improvement of the asset and was deductible under Section 48 (ii) of the Act.

6. The Assessing Officer vide order dated 27th March, 1997 held that Rs.25,00,000/- paid as liquidated damages cannot be allowed as a deduction for computation of capital gains as this payment was not incurred wholly and exclusively in connection with the transfer of the property to the purchaser. The amount paid was not towards cost of improvement or to remove an encumbrance. Even otherwise, as a principle, the amount spent to get rid of any liability or encumbrance cannot be regarded as cost of improvement of a capital asset or expenditure incurred to perfect one's title. Anil Kumar Sharma had not paid the full consideration and was not the first

purchaser within the meaning of Section 53-A of the Transfer of Property Act. The Assessing Officer had also doubted genuineness of the agreement to sell dated 10th April, 1989 with Anil Kumar Sharma, observing that the name of the stamp vendor and his license number were not mentioned on the stamp paper. He observed that the agreement was a piece of paper and not class-one evidence. The Assessing Officer nevertheless invoked and applied Section 51 in respect of Rs.7,50,000/- received from Anil Kumar Sharma in the Financial Year 1989-90 to re-work the indexed cost of acquisition which was reduced from Rs.17,08,000/- to Rs.9,58,000/-.

7. Agreeing with the assessee, the Commissioner of Income Tax (Appeals) held that the agreement to sell with Anil Kumar Sharma was an enforceable contract in law and under the Specific Relief Act, even if the name and license number of the stamp vendor were not indicated. The assessee had received advance of Rs.7,50,000/- which included Rs.4,50,000/- paid by cheque on 10th April,1989 from Anil Kumar Sharma. However, the Commissioner of Income Tax (Appeals) held that the agreement to sell with Anil Kumar Sharma had not stipulated for refund of Rs.7,50,000/- in case of failure to execute the sale deed. The agreement had stipulated lump-sum payment of liquidated damages of Rs.25,00,000/-, which was not in addition to repayment of advance of Rs.7,50.000/-. Reduction of cost of acquisition by Rs.7,50,000/- by the Assessing Officer by applying Section 51 of the Act was upheld. In other words, the Commissioner of Income Tax (Appeals) accepted the contention of the assessee that payment of Rs.25,00,000/- was in connection with the transfer of property and, therefore, should be reduced from the full value of the consideration while computing capital gains.

8. Both the assessee and Revenue preferred appeals before the Tribunal. Tribunal held that Section 48 of the Act permits deduction against sale consideration in three situations. Firstly, towards cost of acquisition; secondly on account of cost of improvement of the property and thirdly, on account of expenditure incurred wholly and exclusively in connection with transfer of property. Rs.25,00,000/- was not a part of cost of acquisition and not paid by way of cost of improvement. Payment of Rs.25,00,000/- to Anil Kumar Sharma, it was held, was personal liability of the assessee and not attached to the capital asset sold and, therefore, it cannot be held that the expenditure incurred was wholly and exclusively in connection with the transfer of property. Reference was made to the agreement to sell dated 4th November, 1993, which did not refer to the agreement with Anil Kumar Sharma or liability to pay liquidated damages and had stated that the property was to be transferred free from all encumbrances. Reliance placed by the assessee on ***R.M. Arunachalam versus Commissioner of Income Tax, Madras,*** (1997) 227 ITR 222(SC) was rejected as inapplicable. An amount paid to clear existing mortgage created by the predecessor would be considered as cost of improvement inasmuch as the mortgage was an encumbrance but the position would be different if the mortgage was created by the owner after acquisition of the property. However, the Tribunal held that there was merit in the contention of the assessee on disallowance under Section 51 of the Act, as the first agreement had not materialized, the assessee had paid Rs.25,00,000/- to Anil Kumar Sharma. It could not be said that the advance received was forfeited. Rs.7,50,000/- could not be deducted from the cost of acquisition and to this extent appeal of the assessee was allowed.

9. Thus, as per facts elucidated and found by the Tribunal, genuineness of the two transactions with Anil Kumar Sharma i.e. agreement to sell dated 10th April, 1989 for Rs.15,00,000/-, payment of advance and on cancellation refund of Rs.7,50,000/- by the purchaser and payment of Rs.25,00,000/- by the assessee to Anil Kumar Sharma for giving up his rights under the agreement to sell are not in doubt. Revenue has not preferred any cross-appeal or objections. Direction that Rs.7,50,000/- could not be deducted from cost of acquisition under Section 51 of the Act is not under challenge before us.

10. We would first refer to the agreement to sell dated 10th April, 1989 between the appellant-assessee and Anil Kumar Sharma for Rs.15,00,000/-, out of which Rs.7,50,000/- was paid as advance. Clauses 4 and 5 of the said agreement had stated as under:-

> "4. That the Second party has already inspected the premises and is satisfied with the documents furnished to the Second party. The property is in occupation of a tenant M/s Kochar Carpets Pvt. Limited and the First Party undertakes to get the said property vacated from the tenant and hand over the vacant and peaceful possession of the said property to the Second party.
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> 5. That the first party herein assures the Second party that the said property is free from all encumbrances, mortgages lines or defect in the title of the property. There are leasehold rights vested in the tenant M/s Kochar Carpets Pvt. Limited and the tenancy is on month to month basis on the basis of English calendar."

Clauses 3, 7 and 8 of the said agreement are also relevant and read as under:-

> 3. That the First party shall execute a proper Sale Deed in favour of Second party and shall deliver the vacant and peaceful possession to the Second party within a reasonable time. The second party shall be entitled for liquidated damages of Rs.25 lakhs if the Sale Deed is not executed within a period of three years from the date of this Agreement.
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> 7. That the First party ensures the Second party that in case of failure to execute a proper Sale Deed and failure to hand over vacant and peaceful possession to the Second party, the Second party shall be entitled to receive liquidated damages of Rs.25,00,000/-. The execution of Sale Deed and handing over of the vacant and peaceful possession into take place within a period of 3 years from the execution of this Agreement.
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> 8. That the First party further assures the Second party and shall indemnify the Second party in case of any defect is found the title of the First party or if there is any creation of any encumbrance and defect found after execution this Agreement, the Second party shall be entitled to claim any loss besides liquidated damages for non-registration of the Sale Deed for handing over the vacant and peaceful possession to the Second party, the First party shall also responsible for any consequences flowing from defect in the title or any hindrances in freely transferring the said property in favour of the Second party to make good any loss that might have occasioned to the Second party."

A reading of the aforesaid clauses would indicate that the assessee had assured Anil Kumar Sharma that the property was free from all encumbrances, mortgage, liens or defect of title. The property was tenanted and the assessee had undertaken to get the property vacated from the tenant and handover vacant and peaceful possession to Anil Kumar Sharma within a reasonable time. Sale deed was to be executed with delivery of vacant peaceful possession. In the event of failure to execute the sale deed and deliver vacant peaceful possession, Rs. 25,00,000/- was to be paid as damages to Anil Kumar Sharma. Clause 7 had stipulated that execution of sale deed etc. should take place within a period of three years from the date of agreement. Clause 8 had stipulated that in case title of the assessee was found to be defective or if there was any creation of encumbrances or defect, the assessee would be liable to pay damages/loss besides liquidated damages for non-registration of sale deed or handing over of vacant peaceful possession. The assessee, it was agreed, shall be responsible for any consequences flowing from defect in the title or any hindrances in free transfer of property in favour of Anil Kumar Sharma and to make good any loss that might be occasioned.

11. Appropriate, at this stage, would be to refer the legal position in terms of Sections 10, 14 and 23 of the Specific Relief Act, 1963, which read as under:-

> "10. Except as otherwise provided in this Chapter, the specific performance of any contract may, in the discretion of the court, be enforced—

(*a*) when there exists no standard for ascertaining the actual damage caused by the non-performance of the act agreed to be done; or

(*b*) when the act agreed to be done is such that compensation in money for its non-performance would not afford adequate relief.

Explanation.— Unless and until the contrary is proved, the court shall presume—

(*i*) that the breach of a contract to transfer immovable property cannot be adequately relieved by compensation in money; and

(*ii*) that the breach of a contract to transfer movable property can be so relieved except in the following cases—

(a) where the property is not an ordinary article of commerce, or is of special value or interest to the plaintiff, or consists of goods which are not easily obtainable in the market;

(*b*) where the property is held by the defendant as the agent or trustee of the plaintiff."

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14. Contracts not specifically enforceable.—

(1) The following contracts cannot be specifically enforced, namely:—

(a) a contract for the non-performance of which compensation in money is an adequate relief;

(b) a contract which runs into such minute or numerous details or which is so dependent on the personal qualifications or volition of the parties, or otherwise from its nature is such, that the court cannot enforce specific performance of its material terms;

(c) a contract which is in its nature determinable;

(d) a contract the performance of which involves the performance of a continuous duty which the court cannot supervise.

(2) Save as provided by the Arbitration Act, 1940 (10 of 1940), no contract to refer present or future differences to arbitration shall be specifically enforced; but if any person who has made such a contract (other than an arbitration agreement to which the provisions of the said Act apply) and has refused to perform it, sues in respect of any subject which he has contracted to refer, the existence of such contract shall bar the suit.

(3) Notwithstanding anything contained in clause (a) or clause (c) or clause (d) of sub-section (1), the court may enforce specific performance in the following cases:—

(a) where the suit is for the enforcement of a contract,—

(i) to execute a mortgage or furnish any other security for securing the repayment of any loan which the borrower is not willing to repay at once: Provided that where only a part of the loan has been advanced the lendor is willing to advance the remaining part of the loan in terms of the contract; or

(ii) to take up and pay for any debentures of a company;
(b) where the suit is for,—

(i) the execution of a formal deed of partnership, the parties having commenced to carry on the business of the partnership; or

(ii) the purchase of a share of a partner in a firm;

(c) where the suit is for the enforcement of a contract for the construction of any building or the execution of any other work on land: Provided that the following conditions are fulfilled, namely:—

(i) the building or other work is described in the contract in terms sufficiently precise to enable the court to determine the exact nature of the building or work;

(ii) the plaintiff has a substantial interest in the performance of the contract and the interest is of such a nature that compensation in money for non-performance of the contract is not an adequate relief; and

(iii) the defendant has, in pursuance of the contract, obtained possession of the whole or any part of the land on which the building is to be constructed or other work is to be executed."

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"**23.** .....(1) A contract, otherwise, proper to be specifically enforced, may be so enforced, though a sum be named in it as the amount to be paid in case of its breach and the party in default is willing to pay the same, if the court, having regard to the terms of

the contract and other attending circumstances, is satisfied that the sum was named only for the purpose of securing performance of the contract and not for the purpose of giving to the party in default an option of paying money in lieu of specific performance.

(2) When enforcing specific performance under this section, the court shall not also decree payment of the sum so named in the contract."

12. The afore quoted Sections were interpreted in ***M.L. Devender Singh and Ors. versus Syed Khaja***, (1973) 2 SCC 515, to hold that it was not the legislative intent that mere proof that a sum of money was specified as liquidated damages and penalty for breach would be enough to prove that the contract for transfer of immovable property cannot be specifically enforced and could be adequately compensated by specified damages or penalty. This, it was observed, would make the provisions of Section 23 of the Act meaningless. Thus, mere specification of damages or penalty in case of breach in order to compel performance of the contract would not be a good defense to a prayer for specific performance. It was held as under:-

"**15.** We think that Section 23 of the Act of 1963 contains a comprehensive statement of the principles on which, even before the Act of 1963, the presence of a term in a contract specifying a sum of money to be paid for a breach of the contract has to be construed. Where payment is an alternative to carrying out the other terms of the contract, it would exclude, by the terms of the contract itself, specific performance of the contract to convey a property.

16. The position stated above is in conformity with the principles found stated in *Sir Edward*

Fry's "*Treatise on the Specific Performance of Contracts*" (Sixth Edn. at p. 65). It was said there:

"The question always is: What is the contract? Is it that one certain act shall be done, with a sum annexed, whether by way of penalty or damages, to secure the performance of this very act? Or, is it that one of the two things shall be done at the election of the party who has to perform the contract, namely, the performance of the act or the payment of the sum of money? If the former, the fact of the penal or other like sum being annexed will not prevent the court's enforcing performance of the very act, and thus carrying into execution the intention of the parties: if the latter, the contract is satisfied by the payment of a sum of money, and there is no ground for proceeding against the party having the election to compel the performance of the other alternative.
From what has been said it will be gathered that contracts of the kind now under discussion are divisible into three classes—

(*i*) where the sum mentioned is strictly a penalty — a sum named by way of securing the performance of the contract, as the penalty is a bond;

(*ii*) where the sum named is to be paid as liquidated damages for a breach of the contract;

(*iii*) where the sum named is an amount the payment of which may be substituted for the performance of the act at the election of the person by whom the money is to be paid or the act done.

Where the stipulated payment comes under either of the two first-mentioned heads, the court will enforce the contract, if in other respects it can and ought to be enforced, just in the same way as a contract not to

do a particular act, with a penalty added to secure its performance or a sum named as liquidated damages, may be specifically enforced by means of an injunction against breaking it. On the other hand, where the contract comes under the third head, it is satisfied by the payment of the money, and there is no ground for the court to compel the specific performance of the other alternative of the contract."

17. Sir Edward Fry pointed out that the distinction between a strict penalty and liquidated damages for a breach of contract was important in common law where liquidated damages were considered sufficient compensation for breach of contract, but, sums stipulated by way of penalty stood on a different footing. He then said:

> "But as regards the equitable remedy the distinction is unimportant; for the fact that the sum named is the amount agreed to be paid as liquidated damages is, equally with a penalty strictly so called, ineffectual to prevent the court from enforcing the contract in specie."

18. The equitable principles which regulated the grant of specific performance by the separate Court of Equity which existed in England at one time have been given statutory form in India. It is, therefore, immaterial that the stipulated payment under the terms of the contract under consideration before us could be viewed as one for payment of liquidated damages. The question would still remain whether the courts are relieved by the agreement between the parties of the duty to determine, on the facts of a particular case, whether damages, specified or left unspecified, would really afford adequate

> compensation to the party which wants a conveyance of immovable property as agreed upon."

13. Section 20, it was held, would show that jurisdiction of the Court to grant the relief of specific performance was discretionary and must be exercised on sound and reasonable grounds. This jurisdiction, however, was not curtailed by merely fixing a sum as liquidated damages. The Court had to determine on the facts and circumstances of each case before it, whether specific performance of a contract to convey an immovable property ought to be granted. When the parties had specified a sum to be paid by a party breaching the contract by itself would not remove strong presumption under the aforesaid sections. The presumption could be negated by evidence, sufficiency and insufficiency of which had to be examined on case to case basis. The fact that parties had specified a sum of money in case of breach, though a piece of evidence to be considered, would not be decisive or conclusive while deciding whether the presumption had been repelled or not. We need not refer to other decisions on the said point as the legal position is clearly elucidated and stated in ***M.L. Devender Singh and Ors.*** (supra).

14. We would now turn our attention to the legal position and refer to the first portion of Section 48 of the Act, which reads as under:-

> "48. *Mode of computation and deductions.*—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:
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> (*i*) expenditure incurred wholly and exclusively in connection with such transfer;

(*ii*) the cost of acquisition of the capital asset and the cost of any improvement thereto.”

The provision states that the income chargeable under the head “capital gains” shall be computed on the basis of full consideration received or accruing as a result of transfer of capital asset after reducing expenditure incurred wholly or exclusively in connection with such transfer, cost of acquisition of the asset and cost of improvement of the asset. We are not required and need not examine other provisions of Section 48 for deciding the present controversy. The expression "expenditure" used in clause (i) in Section 48 should be given the same meaning as used in Section 37 of the Act, except that expenditure may be also capital in nature. Expenditure would primarily connote and has the meaning of spending or paying out. In a given case, it may also cover the amount of loss, which has gone out of the assessee's pocket. Settlement of a claim and payment made can amount to expenditure. Again the words "wholly and exclusively" used in Section 48 are also to be found in Section 37 of the Act and relate to the nature and character of the expenditure, which in the case of Section 48 must have connection i.e. proximate and perceptible nexus and link with the transfer resulting in income by way of capital gain. The word "wholly" refers to the quantum of expenditure and word "exclusively" refers to the motive, objective and purpose of the expenditure. These two words give jurisdiction to the taxing authority to decide whether the expenditure was incurred in connection with the transfer. The expression "wholly and exclusively" however, does not mean and indicate that there must exist a necessity or compulsion to incur an expense before an expenditure is to be allowed.

Supreme Court in ***Chloro Controls India Private Limited versus Severn Trent Water Purification Inc. and Others***, (2013) 1 SCC 641, had noticed and elucidated on dictionary meaning of the word "connection" in an Arbitration clause and had observed:-

> "**145.** The expression "connection" means a link or relationship between people or things or the people with whom one has contact [*Concise Oxford Dictionary* (Indian Edition)]. "Connection" means act of uniting; state of being united; a relative; relation between things one of which is bound up with (*Law Lexicon*, 2nd Edn., 1997). Thus, even the dictionary meaning of this expression is liberally worded. It implies expansion in its operation and effect both. Connection can be direct or remote but it should not be fanciful or marginal. In other words, there should be relevant connection between the dispute and the agreement by specific words or by necessary implication like reference to all other agreements in one (principal) agreement. The expression appearing in Clause 30 has to be given a meaningful interpretation particularly when the principal agreement itself, by specific words or by necessary implication, refers to all other agreements. …"

Word "connection" in Section 48(i) reflects that there should be a causal connect and the expenditure incurred to be allowed as a deduction must be united or in the state of being united with the transfer resulting in income by way of capital gains on which tax has to be paid. The expenditure, therefore, should have direct concern and should not be remote or have indirect result or connect with the transfer. Practical and pragmatic view in the circumstances should be taken to tax the real income i.e. the gain. We have applied the said dictum while interpreting clause (i) of Section 48 of

the Act. The view we have taken is in consonance and resonates with the ratio of the judgments noted below.

15. Supreme Court in ***Sree Meenakshi Mills Limited, Madurai versus Commissioner of Income Tax, Madras,*** (1967) 63 ITR 207 (SC) had observed that the expression "for the purpose of business" in Section 37 of the Act was wider than the expression "for the purpose of earning income" and would, therefore, mean for the purpose of enabling a person to carry on and earn profits in trade as was also observed in ***Commissioner of Income Tax, Kerela versus Malyalam Plantations Limited, Quilon***, (1964) 53 ITR 140 (SC) that these are words of a wide range and scope and much broader than the expression "for the purpose of earning profit". It may include many other acts incidental to carrying on business.

16. In ***The Delhi Cloth and General Mills Co. Ltd., Delhi versus The Commissioner of Income Tax, New Delhi***, (1980) 125 ITR 96 (Delhi), donation to a political party was disallowed as business expense. However, it was observed that payment for political purposes could be for business purposes where link between the trade and payment was established. It was clarified that that expenditure incurred voluntarily but wholly and exclusively for the expender's trade in given circumstances would be permissible deduction even though it ensures to some extent benefit to a third party. In ***Commissioner of Income-Tax, Delhi VIII versus Shakuntala Rajeshwar***, (1986) 160 ITR 840 (Delhi) payment made to tenant to vacate was held as incurred to effectuate the transfer of immovable property and therefore incurred wholly and exclusively in connection with the transfer. In ***Smt. Sita Nanda versus Commissioner of Income Tax***,

[2001] 251 ITR 575 (Del.) had held the payment made to the superior lessor for permission to sell the leasehold rights in the form of unearned increase was allowable as a deduction as the expense incurred was wholly and exclusively in connection with the transfer. However, interest paid in the shape of damages for late payment of unearned increase, it was held would not be expenditure incurred wholly and exclusively in connection with the transfer.

17. In ***Commissioner of Income Tax versus Shakuntala Kantilal,*** (1991) 190 ITR 56 (Bombay), the Bombay High Court had observed as under:-

> "The Legislature, while using the expression "full value of consideration", in our view, has contemplated both additions to as well as deductions from the apparent value. What it means is the real and effective consideration. That apart, so far as clause (i) of section 48 is concerned, we find that the expression used by the Legislature in its wisdom is wider than the expression "for the transfer". The expression used is "the expenditure incurred wholly and exclusively in connection with such transfer". The expression "in connection with such transfer" is, in our view, certainly wider than the expression "for the transfer". Here again, we are of the view that any amount the payment of which is absolutely necessary to effect the transfer will be an expenditure covered by this clause. In other words, if, without removing any encumbrance including the encumbrance of the type involved in this case, sale or transfer could not be effected, the-amount paid for removing that encumbrance will fall under clause (i). Accordingly, we agree with the Tribunal that the sale consideration requires to be reduced by the amount of compensation. The first question is,

> therefore, answered in the affirmative and in favour of the assessee."

In the said case, the first transaction/agreement to sell had resulted in litigation, which was settled on payment of money, a pre-condition and mandate in the second transaction. The consideration paid to the first party was, therefore, allowed as an expenditure incurred wholly and exclusively in connection with such transfer.

18. In an earlier decision in ***Commissioner of Income Tax, Tamil Nadu-II versus A. Venkataraman and Others***, (1982) 137 ITR 846(Mad.), it was observed as under:-

> "**6.** The second question of law in both the groups of reference relates to a claim for deduction made by the assessees under s. 48 of the Act. The claim was disallowed by the ITO, but his decision was reversed on appeal by the Tribunal. The claim arose in the following circumstances, having a bearing on the sales of the assessees' properties. The facts are not in dispute. When the assessees entered into an agreement for the sale of the properties in question, there were tenants in occupation of those properties. The purchasers, who had entered into the agreement of purchase insisted that the assessees should render to them vacant possession of the properties. In other words, this was one of the conditions of the conveyance. The assessees had, therefore, to arrange to vacate the tenants in occupation of the properties, so as to render vacant possession to the purchasers in terms of the agreement of sale. It appears from the statement of case, that there were two tenants, M/s. Dunlop India Ltd. and M/s, Harrison and Company. They had to be given Rs. 9,500 in all as consideration for their agreeing to vacate the properties. This amount was paid and the tenants vacated the properties, and in turn

> vacant possession was rendered by the assessee to the purchasers. In the assessment to capital gains on the sale of the properties in question, the assessee claimed that the payments made by them to the tenants in order to secure vacant possession was expenditure incurred wholly and exclusively in connection with the transfer of the properties, within the meaning of s. 48(i) of the Act. The Tribunal upheld this claim in appeal.
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> **7.** The department's contention is that this item of expenditure cannot come in for reckoning under s. 48(i). We do not accept this contention as well founded. The finding of the Tribunal is that the purchasers of the property from the assessees insisted on vacant possession being rendered as part of the condition of purchase of the properties. It, therefore, behoved the assessees to arrange with the tenants, who were then in possession of the properties, to render vacant possession. But the tenants were unwilling to vacate unless they were paid the sum of Rs. 9,500. These facts clearly show that the expenditure was incurred wholly and exclusively in connection with the agreement of sale, which preceded the transfer and in fulfilment of a condition of sale. We have no doubt whatever that the Tribunal was quite right in bringing the expenditure under s. 48(i) of the Act. Our answer to the second question in both the groups of references is, therefore, against the department."

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19. More direct would be the decision of the Madras High Court in ***Commissioner of Income Tax versus Bradford Trading Co. Pvt. Ltd.,*** (2003) 261 ITR 222(Mad.) wherein it has been held as under:-

> "**13.** We therefore hold that the amount of Rs. 2 lakhs was paid to get over the difficulties created by A.M. Buhari for the sale of the property and unless the amount was paid, the transfer of property would not

have taken place at all. We, therefore, hold that the Appellate Tribunal was right in holding that the payment had an intimate connection with the transfer of the undertaking as by allowing the litigation to go on the hands of the company would be tied against the transfer of the undertaking in favour of India Tobacco Company Limited and the assessee would not have realised the sale consideration from the prospective purchaser. In so far as a sum of Rs. 1.5 lakhs paid by India Tobacco Company Limited is concerned, we are of the view that though the sum of Rs. 1.5 lakhs was paid by the said company only to settle the claim of A.M. Buhari, the money was received by the assessee in connection with the transfer of the hotel undertaking and it would form part of sale consideration. However, since the money was paid by the assessee-company, it would also constitute an expenditure wholly and exclusively in connection with the transfer. In the case of payment of Rs. 50,000, the same analogy would apply. In so far as the litigation expenditure of a sum of Rs. 16,000 is concerned, we hold that the Appellate Tribunal was right in holding that the litigation expenditure was also incurred wholly and exclusively in connection with the transfer and thus, it was deductible."

Reference was also made to ***Commissioner of Income Tax versus Abrar Alvi***, [2001] 247 ITR 312 (Bom.). In the said case, demand of Rs.2 lacs made in respect of the former transaction was allowed as a deduction holding that there were impediments against the transfer by way of litigation and unless the amount were paid, litigation would not have been settled enabling the assessee to transfer the property in favour of the assessee giving up clear title and acknowledgement. Similar view has been taken by the Calcutta High Court in ***Commissioner of Income Tax, Kolkata-XI versus Satyabrata Dey***, (2014) SSC Online Cal 9978 wherein the assessee

was allowed deduction of Rs.72 lacs paid pursuant to an award to a third party with whom the assessee had entered into agreement to sell for transfer of flats. Calcutta High Court followed the judgment of the Bombay High Court in ***Shakuntala Kantilal*** (supra) and Madras High Court in ***Bradford Trading Company Private Limited*** (supra).

20. Reliance placed by the Revenue on the judgment of Bombay High Court in ***Commissioner of Income Tax, Mumbai City-XIII versus Roshanbabu Mohammed Hussein Merchant***, (2005) SCC Online Bombay 83, is misconceived for the said decision was again a case of mortgage wherein payment made was to redeem the mortgage. Decision in ***Shakuntala Kantilal*** (supra) was distinguished after referring to judgments of the Supreme Court in ***R.M. Arunachalam*** (supra), ***V.S.M.R. Jagdishchandran (Dead) By LRs. versus Commissioner of Income Tax, Madras,*** [1997] 227 ITR 240 (SC) and ***Commissioner of Income Tax, Vishakapatanam versus Attili N. Rao,*** [2001] 252 ITR 880. It was observed that there was a distinction between an obligation to discharge the mortgage debt created by the previous owner and the obligation to discharge the mortgage debt created by the assessee himself. In the former case, the assessee does not acquire absolute interest in the property from the previous owner and, therefore, discharge of the mortgage debt was deductible. In the latter case, the assessee had acquired the property, which was unencumbered and, therefore, the assessee had absolute interest in that property on acquisition. If the assessee would subsequently encumber the property and for transferring the property had repaid the mortgage debt, the said expenditure was not deductable. ***V.S.M.R. Jagdishchandran*** (supra) was

again a case of mortgage created by the assessee himself and, therefore, repayment of mortgage debt, it was observed was not either cost of acquisition or cost of improvement. ***Attili N. Rao*** (supra) rejected the contention that repayment of the mortgage amount and the diversion of income by overriding title observing that the sale price received belonged to the assessee from the sale price, if same amount is paid towards instalments and interest on another account, it cannot be allowed as a deduction.

21. In ***R.M. Arunachalam*** (supra) question arose whether estate duty paid on inheritance of the immovable property, which was subsequently sold, could be allowed as a deduction while computing capital gains. The contention of the assessee was that Section 74(1) of the Estate Duty Act creates a first charge on the immovable property of the deceased for the purpose of securing payment of estate duty. The contention was rejected on the ground that estate duty paid on inheritance by the assessee on the property, which was subsequently sold, cannot be treated as cost of acquisition or cost of improvement. Referring to Section 53 of the Estate Duty Act, it was observed was a liability of the assessee as the accountable person, which was personal but limited to the assets of the deceased actually received or which might have been received by the accountable person. Section 74(1) of the Estate Duty Act cannot be construed as a creating interest in the property, i.e., the charge, for the provision was related to the matter of recovery of estate duty and that Revenue had priority over other liability of the accountable persons. Provision had incorporated principle of precedence over claim of the mortgagee. It does not affect the title or the inheritance making them incomplete or imperfect in any way. Payment of

estate duty would not result in acquisition of a new right, tangible or intangible in the inherited assets and, therefore, could not be treated as either cost of acquisition or cost of improvement. This judgment specifically referred to Section 100 of the Transfer of Property Act, 1887 on the question of charge.

22. Supreme Court on interpreting Section 74 of the Estate Duty Act had held that no interest had been created in the immovable property, which was subject matter of prior charge. However, while affirming the decision of the High Court, the Supreme Court deemed it appropriate to specifically overrule the ratio in ***Ambat Echukutty Menon versus Commissioner of Income Tax***, (1978) 111 ITR 880 (Ker). It was observed as under:-

> "**30.** While we are affirming the impugned judgment of the High Court, we are unable to endorse the view of the Kerala High Court in *Ambat Echukutty Menon* v. *CIT* [(1978) 111 ITR 880 : 1978 KLT 6 (Ker)] to which reference has been made by the High Court in the impugned judgment. In that case, the assessee, as one of the heirs, had inherited property from the previous owner who had mortgaged the same during his lifetime and after his death the heirs, including the assessee, had discharged the mortgage created by the deceased. The said property was subsequently acquired under the Land Acquisition Act and for the purpose of capital gains the assessee sought deduction of the amount spent to clear the mortgage. The High Court held that the capital asset had become the property of the assessee by succession or inheritance on the death of the previous owner under Section 49(1) of the Act and the cost of acquisition of the asset is to be deemed to be the cost for which the previous owner acquired it, as increased by the cost of any improvement of the assets incurred or borne either

by the previous owner or by the assessee. According to the High Court, having regard to the definition of the expression “cost of improvement” contained in Section 55(1)(*b*) of the Act, in order to entitle the assessee to claim a deduction in respect of the cost of any improvement, the expenditure should have been incurred in making any additions or alterations to the capital asset that was originally acquired by the previous owner and if the previous owner had mortgaged the property and the assessee and his co-owners cleared off the mortgage so created, it could not be said that they incurred any expenditure by way of effecting any improvement to the capital asset that was originally purchased by the previous owner. This decision has been followed in subsequent decisions of the High Court in *Salay Mohamad Ibrahim Sait* v. *ITO* [(1994) 210 ITR 700 (Ker)] and *K.V. Idiculla* v. *CIT* [(1995) 214 ITR 386 (Ker)] . A contrary view has been taken by the Gujarat High Court in *CIT* v. *Daksha Ramanlal* [(1992) 197 ITR 123 (Guj)] . In taking the view that in a case where the property has been mortgaged by the previous owner during his lifetime and the assessee, after inheriting the same, has discharged the mortgage debt, the amount paid by him for the purpose of clearing off the mortgage is not deductible for the purpose of computation of capital gains, the Kerala High Court has failed to note that in a mortgage there is transfer of an interest in the property by the mortgagor in favour of the mortgagee and where the previous owner has mortgaged the property during his lifetime, which is subsisting at the time of his death, then after his death his heirs only inherit the mortgagor's interest in the property. By discharging the mortgage debt his heir who has inherited the property acquires the interest of the mortgagee in the property. As a result of such payment made for the purpose of clearing off the mortgage the interest of the mortgagee in the property

> has been acquired by the heir. The said payment has, therefore, to be regarded as "cost of acquisition" under Section 48 read with Section 55(2) of the Act. The position is, however, different where the mortgage is created by the owner after he has acquired the property. The clearing off the mortgage debt by him prior to transfer of the property would not entitle him to claim deduction under Section 48 of the Act because in such a case he did not acquire any interest in the property subsequent to his acquiring the same. In *CIT* v. *Daksha Ramanlal* [(1992) 197 ITR 123 (Guj)] the Gujarat High Court has rightly held that the payment made by a person for the purpose of clearing off the mortgage created by the previous owner is to be treated as cost of acquisition of the interest of the mortgagee in the property and is deductible under Section 48 of the Act.

The aforesaid ratio observed that where the property was mortgaged by a previous owner during his lifetime, the inheritor would be entitled to deduct the amount paid to discharge the mortgage debt for computing capital gains. The reason being that the mortgage had created interest in the property, which was subsisting at the time of death of the original owner. Payment by the inheritor would be cost of acquisition for acquiring the right. Albeit, the position would be different where the mortgage was created by the owner after he had acquired the property for in such cases the mortgage debt prior to the transfer of property would not entitle him to claim deduction under Section 48 of the Act. Reference was made to the ratio in ***Commissioner of Income Tax versus Daksha Ramanlal***, [1992] 197 ITR 123 (Guj.). The position would have been still different if the property was mortgaged for the purpose of upgrading and making addition to the immovable property. In that event, money paid to redeem the mortgage could be reduced treating it as the cost of improvement.

23. The Tribunal in the impugned order has observed that the agreement dated 4th November, 1993 had mentioned that the property was being transferred free from all encumbrances and did not whisper or refer to the contents of the first agreement to sell or liability to pay Anil Kumar Sharma. There was nothing in the agreement to sell dated 4th November, 1993 that the said transfer could not be affected till payment of Rs.25,00,000/- to Anil Kumar Sharma and, therefore, the liability was personal to the assessee and not attached to the property. Accordingly, the decision in the case of ***Shakuntala Kantilal*** (supra) was distinguishable for in the said case the payment was absolutely necessary to affect the transfer and, therefore, was an expenditure incurred allowable as a deduction.

24. The words "wholly and exclusively" require and mandate that the expenditure should be genuine and the expression "in connection with the transfer" require and mandate that the expenditure should be connected and for the purpose of transfer. Expenditure, which is not genuine or sham, is not to be allowed as a deduction. This, however, does not mean that the authorities, Tribunal or the Court can go into the question of subjective commercial expediency or apply subjective standard of reasonableness to disallow the expenditure on the ground that it should not have been incurred or was unreasonably large. In the absence of any statutory provision, on these aspects discretion exercised by the assessee who has incurred the said expenditure must be respected, for interference on subjective basis will lead to unpalatable and absurd results. As in the case of Section 37 of the Act, jurisdiction of the authorities, Tribunal or Court is confined to investigate and decide as to whether the expenditure was actually incurred, i.e., the

expenditure was genuine and was factually expended and paid to the third party. Secondly, the authorities, Tribunal and Court can examine whether the said expenditure was "wholly and exclusively" connected with the transfer, but once the amount was spent and paid, the authorities, Tribunal and Courts cannot decide commercial expediency by putting themselves in the arm chair of the assessee to examine and consider whether they would have or the assessee should have incurred the said expenditure including the quantum having regard to the circumstances. Excessive expenditure cannot be disallowed when it is "wholly and exclusively" in connection with the transfer, on the ground that prudence did not require the assessee to incur the expenditure. Disallowance on such grounds must be specified and provided by the statute.

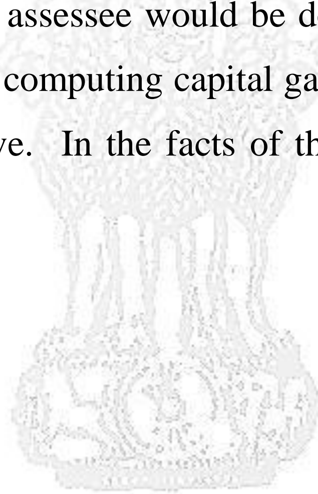
25. The assessee had always stated that the purchaser was aware of the agreement to sell with Anil Kumar Sharma and had directly paid Rs.7,50,000/- by way of cheque to him. The assessee and Anil Kumar Sharma had jointly located the purchaser, who had agreed to pay total consideration of Rs.1 crore, which included Rs.45,00,000/- to be paid to the tenant and Rs.55,00,000/- to be paid to the assessee. Rs.25,00,000/- was paid by the assessee to Anil Kumar Sharma vide cheque dated 16th December, 1993, which is after the agreement to sell dated 4th November, 1993. The assessee has also placed on record copy of the agreement dated 16th December, 1993 with Anil Kumar Sharma with regard to payment of liquidated damages as per the settlement. Anil Kumar Sharma was a signatory as a witness to some of the documents executed in favour of the purchaser at the time of transfer.

26. Looking at the totality of the aforesaid circumstances and on the basis of findings recorded by the Tribunal, we would hold that there was a close nexus and connect between the payment of Rs.25,00,000/- and the transfer of the property to the purchaser resulting in income by way of capital gains. There was proximate link and the expenditure incurred was in furtherance and to effectuate the transfer/sale of the property and was not remote and unconnected. Expenditure of Rs.25,00,000/-, therefore, has to be treated as expense incurred wholly and exclusively in connection with the transfer of immovable property and, hence, allowable as a deduction under clause (i) of Section 48 of the Act. However, we would like to clarify that Rs.7,50,000/- which was paid by Anil Kumar Sharma and subsequently refunded, cannot be allowed as a double deduction. In other words, refund of Rs.7,50,000/- would mean that the earlier payment made by Anil Kumar Sharma was squared off. The assessee had in fact incurred expenditure of Rs.25,00,000/- which was paid to Anil Kumar Sharma to forego and give up his right under the agreement to sell dated 10th April, 1989.

27. Aforesaid ratio and findings should not be interpreted to mean that wherever an assessee has paid an amount under an earlier agreement-to-sell in terms of the settlement or even a court decree, the said amount would be treated as expenditure wholly or exclusively in connection with the transfer, the subject matter of capital gains. The nature and character of the agreement, timing of the earlier agreement and payment claimed as expenditure and the date of transfer resulting in capital gains, are relevant aspects, which should be taken into consideration. For example, an agreement-to-sell rescinded or cancelled and payment made long before the

date on which immovable property was transferred resulting in capital gains, may not be expenditure incurred wholly and exclusively in connection with such transfer. The words used in clause (i) do not permit and allow expenditure incurred wholly and exclusively on the immovable property as an expenditure to be deducted while computing capital gains. Link and connection with the transfer of a capital asset and the expenditure must be inextricable and should be established.

28. Recording the aforesaid caveat, we would answer the substantial question of law in favour of the appellant-assessee and against the Revenue. Rs. 25,00,000/- paid by the assessee would be deducted under clause (i) to Section 48 of the Act while computing capital gains. The appeal is allowed to the extent indicated above. In the facts of the case, there would be no order as to costs.



-sd-
(SANJIV KHANNA)
JUDGE

-sd-
(PRATHIBA M. SINGH)
JUDGE

APRIL 20, 2018
NA/VKR