

PETITIONER:
THE COMMISSIONER OF INCOME-TAX, BOMBAY

Vs.

RESPONDENT:
SMT. KASTURBAI WALCHAND TRUST, BOMBAY

DATE OF JUDGMENT:
31/10/1966

BENCH:
BHARGAVA, VISHISHTHA
BENCH:
BHARGAVA, VISHISHTHA
SHAH, J.C.
RAMASWAMI, V.

CITATION:
1967 AIR 844 1967 SCR (1) 7

ACT:
Income Tax Act 1922, s. 4(3)(i)-Income of trust property-payable to beneficiary during her lifetime-Thereafter for specified charitable purposes-Beneficiary executing surrender of beneficial interest-Thereafter whether trust property held wholly for charitable purposes and exempt from tax-Whether income of trust property receivable by beneficiary or by trust on behalf of beneficiary.

HEADNOTE:

By a deed executed in November 1946, the respondent and her husband created a trust in respect of their properties. In accordance with Clause 7 of the deed, the income of the trust properties was to be paid to the respondent during her lifetime and, by Clause 8 the trustees were directed to apply the income, from and after the death of the respondent, to certain charitable purposes enumerated in the deed. On July 21, 1955, the respondent executed a deed of surrender whereby she gave up her beneficial interest in the income of the trust so that it may immediately vest in the trustees and may be utilised for the charitable purposes mentioned in the trust deed.

In the course of assessment to income tax in respect of the income from the trust properties for the assessment years 1956-57 to 1959-60, it was claimed on behalf of the trust that during the relevant previous years, the properties were held under a trust wholly for charitable purposes, and consequently, the income was exempt from income-tax under s. 4(3)(i) of the Income Tax Act, 1922. The Income Tax Officer rejected this claim on the view that the deed of surrender executed by the respondent did not amount to renouncement of her rights under the trust deed and that it really amounted to a transfer of the income received by her for the use of the trust; and since the income was receivable by the respondent, the trust properties were not held wholly for charitable purposes. However, the Appellate Assistant Commissioner, on appeal held that the income from the trust properties was exempt under s. 4(3)(i) and this view was upheld by the Tribunal. The High Court, upon a reference, also held in favour of the trust.

It was also contended on behalf of the department that as

clause 8 of the trust deed executed in November 1946 provided that the income of the trust was to be applied for charitable purposes "from and after the death" of the respondent the trustees could not, during her life-time, apply the income for any charitable purposes and therefore no exemption could be claimed under s. 4(3) (i).

HELD: The income from the trust properties -after July 21, 1955 was exempt from tax under s. 4(3) (i). [13 B-C] Whenever a valid trust is executed, the property vests in the Trustees, and the income accruing from those properties is the income of the trust and not of the beneficiaries. For purposes of income-tax law, however, the income under s. 41(1) of the Act is treated as received by the Trustees on behalf of the beneficiaries, but is to be taxed in the hands of the Trustees as it would be in the hands of the beneficiary for whom it is

received. In the present case, therefore, it would be wrong to proceed on any assumption that the income of the trust properties was received by the respondent. Once the respondent renounced her interest by the deed of July 1955, which was clearly valid in view of s. 58 of the Indian Trusts Act, the entire properties were held by the Trustees for the charitable purpose mentioned in clause 8, because that was the only purpose of the trust which then remained. The income which accrued thereafter was income which could be applied or allowed to accumulate for application to the charitable purposes mentioned in clause 8 and for no other purpose. [10 E; 11 B-H]

Even if it were to be held that by virtue of clause 8 the trustees could not apply the income for charitable purposes so long as the respondent was alive, the only effect would be that the income would accumulate. Such accumulations would also be exempt from the liability to income-tax under s. 4(3) (i) as soon as the rights of the respondent ceased on the execution by her of the deed of surrender in July 1955. [12 F-]

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 180 to 183 of 1966.

Appeal by special leave from the judgment and order dated September 27, 1962 of the Bombay High Court in Income-tax Reference No. 42 of 1961.

B. Sen, Gopal Singh and B. N. Sachthey, for the appellant (in all the appeals).

S. T. Desai and Ravinder Narain, for the respondent (in all the appeals).

The Judgment of the Court was delivered by Bhargava, J. Seth Walchand Hirachand and his wife, Dai Kasturbai, owned certain shares, had several insurance policies, owned house property and also held lease lands. The two of them together joined in executing an indenture on 25th November, 1946, by which they created a trust. The trustees were both of them themselves and three brothers of Seth Walchand. The provisions of the trust, with which we are concerned, laid down that, after defraying the expenses for management of the trust properties and certain other expenses, such as, rents, rates, etc., the trustees were to pay to Bai Kasturbai, during her lifetime, the income arising from the trust funds and properties. Further, Seth Walchand himself and Bai Kasturbai, during their life-time, had the right of residence in some of the house property,

free of rent and without any obligation for payment of any out goings or moneys in respect thereof. These provisions were contained in clause 7 of the deed of trust. The next provision contained in clause 8 of the deed was that, from and after the death of Bai Kasturbai, the trustees were directed to apply the net rents, profits and income of the properties and trust funds, at their discretion, on charitable purposes enumerated in the deed of trust. It is not disputed that all the charitable purposes mentioned in the trust constituted public charities. Seth

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Walchand died and, thereafter, Bai Kasturbai, on 21 st July, 1955, executed a deed in which the relevant clause runs as follows:-

"Bai Kasturbai Walchand both hereby surrender, release, quit claim, transfer and assign unto the Trustees all the income to arise as from the 21st day of July one thousand nine hundred and fifty-five from the Trust funds of the investments for the time being representing the same and her beneficial life interest and all her rights, claims and demands under the said Indenture of Settlement including the liberty to occupy and enjoy rent free of the lands, hereditaments, messuages and premises described in the First and Second Schedules hereto the intent that her beneficial interest may be determined as aforesaid and that the same may be immediately vested in the Trustees and that the Trustees may utilise the same for charitable purposes mentioned in the said Indenture of Settlement."

Subsequent to the execution of this deed, the question arose of assessment to income-tax of the income from the trust properties for the assessment years 1956-57, 1957-58, 1958-59 and 1959-60. The corresponding previous years were the financial years ending on 31st March in the years 1956 to 1959. It was claimed by the Trust that, during these previous years, these properties were held under a trust wholly for charitable purposes, and consequently, the income was exempt from income-tax under s. 4(3)(i) of the income-tax Act (hereinafter referred to as "the Act"). The Income-tax Officer, however, held that the deed executed by Bai Kasturbai did not amount to a renouncement of her rights under the trust deed, and that it really amounted to a transfer of the income received by her for purposes of the use of the trust. Since the income of the trust was receivable by Bai Kasturbai, it could not be held that the trust properties were held wholly for charitable purposes. On appeal, the Appellate Assistant Commissioner, disagreed with the Income-tax Officer and accepted the submission made by the respondent, holding that the income received by the Trust, after the execution of the deed of surrender by Bai Kasturbai, was exempt from tax under s. 4(3)(i) of the Act in view of the applicability of s. 9 of the Indian Trusts Act, 1882. The Income-tax Appellate Tribunal, on further appeal, upheld the same decision, but on a slightly different ground. The Tribunal's view was that the surrender by Bai Kasturbai was valid under s. 58 of the Indian Trusts Act, and consequently, after that deed was executed, the properties were held wholly for charitable purposes and the income was exempt from tax under s. 4(3)(i) of the Act. Thereupon, at the request of the Commissioner of Income-tax, the following question was referred for the opinion of the High Court of Bombay:

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"Whether clause 8 of the trust, settlement made on the 25th November, 1946, came into operation immediately following the declaration made by Bai Kasturbai on the 21st July, 1955, and as such the income that accrued or arose to the trustees from the trust property from 21st July, 1955, onwards was exempt under s' 4(3)(i) of the Act?"

The High Court answered the question in favour of the Trust, which is the respondent in these appeals before us, and consequently, the Commissioner of Income-tax has come up to this Court in these appeals by special leave.

It appears that, in this case, the question that was framed by the Income-tax Appellate Tribunal and referred to the High Court was not happily worded, so that it will need a slight amendment which we shall indicate later. The real question under dispute was whether, after the execution of the deed of surrender on 21st July, 1955, the income from the trust properties was exempt from income-tax under S. 4(3)(i) of the Act or not. In dealing with this question, it has to be kept in view that, even under the deed of trust as originally executed on 25th November, 1946, the income from the trust properties was not the income of Bai Kasturbai. Whenever a valid trust is executed, the property vests in the Trustees, and the income accruing from those properties is the income of the trust and not of the beneficiaries. For purposes of income-tax law, however, the income under s. 41(1) of the Act is treated as received by the Trustees on behalf of the beneficiaries, but is to be taxed in the hands of the Trustees in the like manner and to the same amount as it would be leviable upon the person on whose behalf such income is receivable. The liability of the income to tax is, therefore, independent of the income actually being received by the beneficiaries and may be subjected to tax as soon as it is earned by the trust. The exception is that, where the trust properties are held wholly for charitable or religious purpose in so far as such income is applied or accumulated for application to such religious or charitable purposes, it is exempt from income-tax. In the present case, therefore, in dealing with the question referred to the High Court, any assumption that the income of the trust properties was received by Bai Kasturbai will not be correct. The income during her life-time was clearly taxable as income in the hands of the trustees received by them on behalf of Bai Kasturbai.

Subsequently, when Bai Kasturbai executed the deed of surrender on 21st July, 1955, she made a declaration that she was giving up all her rights to the income. In clear words, she stated in the deed that she was surrendering, releasing, transferring and assigning unto the trustees all the income which was to arise after that date from the trust properties, and that she was also surrendering all her rights, claims and demands under the deed of trust, including

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her right to occupy and enjoy rent-free lands, hereditaments, messuages and premises described in the trust-deed. It was further stated by her that the deed was executed with the intent that her beneficial interest may be determined and the same may be immediately vested in the Trustees and that the Trustees may utilise the same for charitable purposes mentioned in the deed of trust. This deed executed by Bai Kasturbai was clearly valid in view of the provision contained in s. 58 of the Indian Trusts Act

(No. 2 of 1882) which provides that "the beneficiary, if competent to contract, may transfer his interest but subject to the law for the time being in force as to the circumstances and extent in and to, which he may dispose of such interest." Bai Kasturbai was quite competent to contract so as to transfer her interest under the deed of trust, and by executing the deed dated 21st July, 1955, she surrendered all her rights. The right which had accrued to her under clause 7 of the deed of trust was the right to use certain immovable properties and to receive the net income arising from trust properties. The right to receive the income arose because of the obligation laid on the Trustees to pay the net income to her during her life-time. That was clearly the right as a beneficiary under the trust, and when she executed the indenture dated 21st July, 1955, she surrendered that right in favour of the trust for charitable purposes, so that her right became extinguished. It may be mentioned that, at one stage, an attempt was made on behalf of the Commissioner of Income-tax to raise the question about the validity of this deed of surrender, but, when the Commissioner asked the Tribunal to refer a question about the competence of Bai Kasturbai to renounce her beneficial interest under the Trust, Settlement, that request was refused by the Tribunal. The Commissioner did not, thereafter, move the High Court to obtain a statement of the case from the Tribunal on that question, so that, in these appeals, it is no longer open to the Commissioner to contend that Bai Kasturbai was not competent to renounce her beneficial interest. Once she renounced her interest, the direction contained in the deed of trust to the Trustees to pay to her the net income of the trust properties ceased, though the Trustees continued to hold the property under the trust. At the same time, the right of Bai Kasturbai to use the immovable properties also ceased to exist. Thereafter, clearly, the entire properties were held by the Trustees, for the charitable purposes mentioned in clause 8, because that was the only purpose of the trust which remained after this deed of surrender had been executed by Bai Kasturbai. On these facts, it is clear that the income, which accrued from the trust properties thereafter, was income which could be applied or allowed to accumulate for application to the charitable purposes mentioned in clause 8 and for no other purpose.

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High Court and the Tribunal as to whether clause 8 of the deed of trust could come into effect so as to permit the Trustees to apply the income of the trust properties for the charitable purposes mentioned in that clause even before the death of Bai Kasturbai. That clause, in clear words says that the Trustees shall apply the -said net rents, profits and income, etc. in all or any of the charitable purposes mentioned therein "from and after the death of Bai Kasturbai". Relying on this last expression, it was urged that unless Bai Kasturbai died, the Trustees were not permitted to apply the income for the charitable purposes mentioned in clause 8. It seems to us that, in this case, it was quite unnecessary to go into this question for the purpose of deciding whether the income of the trust properties, after the deed of surrender by Bai Kasturbai executed on 21st July, 1955, was exempt from income-tax under s. 4(3)(i) of the Act. Under that provision, the income from trust properties, held wholly for charitable or religious purposes, is exempt from tax under two circumstances. The first is when that income is actually applied for such religious or charitable purposes, and the

second is when it is accumulated for application to such religious or charitable purposes. In this case, as we have indicated above, as soon as Bai Kasturbai executed the deed of surrender, her rights under clause 7 completely ceased and all the income from the trust properties remained with the Trustees to be applied in accordance with other terms of the deed of trust. If it could be held that clause 8 came into operation and permitted the application of that income to the charitable purposes mentioned in it as soon as Bai Kasturbai's rights ceased, even though she remained alive, there would be no difficulty in holding that s. 4(3)(i) would have exempted the income from income-tax. In fact, this view was accepted by all the income-tax authorities. However, even if it be held that clause 8 did not come into operation and the Trustees were incompetent to apply the income of the trust properties for the purposes mentioned in it so long as Bai Kasturbai was alive, the only effect would be that that income would accumulate and that accumulation would continue during the life-time of Bai Kasturbai. On her death, the accumulated income would have to be applied by the Trustees for the charitable purposes mentioned in clause 8. Consequently, the income of the trust properties became exempt from liability to income-tax as soon as the rights of Bai Kasturbai ceased on execution by her of the deed of surrender dated 21st July, 1955, even though it may not be held that clause 8 came into operation from that very date. It is in these circumstances that we consider that, in framing the question, the Tribunal committed an error. The exemption of the income of the trust properties from liability to income-tax was not dependent entirely on coming into operation of clause 8. and we, therefore, think that the question framed should have been broken up into two parts as follows:-

" (1) Whether clause 8 of the Trust Settlement made on 25th November, 1946, came into operation immediately following the declaration made by Bai Kasturbai on 21st July, 1955, and

(2) Whether, in the circumstances of this case, the income that accrued or arose to the Trustees from the trust properties from 21st July, 1955, onwards was exempt under section 4(3)(i) of the Act."

If the question is so broken up, the first question becomes unnecessary, and the second question has to be answered in favour of the respondent. The answer to the second question is the only one that is material for purposes of determining the liability of the income of the Trust to tax. That question has been answered by the High Court in favour of the respondent. The appeals, therefore, fail and are dismissed with costs. There will be one bearing fee.

R.K.P,S.
dismissed.

Appeals