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April 28

## COMMISSIONER OF INCOME-TAX, PATNA

v.

RANI BHUWANESHWARI KUER

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

*Indian Income-tax Act, 1922 (11 of 1922) s. 16(1)(c) and its proviso three—Deed of trust by assessee—Beneficiaries of the Trust are assesseees and other persons—Trust and revocable within six years—If the income of the Trust can be included as part of the income of the assessee.*

The assessee (respondent) owner of an estate known as "Tekari Raj" executed an indenture of trust dated January 20, 1941 whereby the "Tekari Raj" and certain Zamindari properties owned by her were conveyed to certain named trustees to be held in trust, subject to conditions specified therein. This deed was created with a view to liquidate the debts of the Tekari Raj. The beneficiaries under the deed were the settlor, her husband and her five sons. This original deed was modified by a deed of rectification dated December 22, 1941. It was provided in the original cl. 43 of the deed of trust dated January 20, 1941, that the settlor may at any time during her life revoke or vary either wholly or partly the trust or any provisions of the deed but not before the payment and discharge of certain debts and liabilities. Clause 43 of the original deed was subsequently modified by the 45th clause which was added by the deed of amendment dated January 12, 1942. By cl. 45 of the deed of amendment the right of revocation was not exercisable till the *Thica* leases in favour of the Maharajadhiraj of Darbhanga and Capt. Maharaj Kumar Gopal Saran Narain Singh remained good and effective. It was the common ground that the lease in favour of the Maharajadhiraj of Darbhanga was to enure till 1965 and the lease in favour of Capt. Maharaj Kumar Gopal Saran Narain Singh till 1954.

In assessing the assessee to income-tax for the year 1947-48, the Income-tax Officer included in her total income the income of the trust. The matter went up to the High Court and the High Court set aside the assessment order passed by the Income-tax Officer. The High Court held that as the trust was not revocable for a period of six years, the income received by the beneficiaries (other than the assessee) was not liable to be taxed as the assessee's income till the power to revoke arose in her favour. The appellant obtained special leave against the order passed by the High Court. Hence the appeal.

The principal question for consideration before this Court was whether the income received by the beneficiaries other than the assessee could be included in the total income of the assessee under s. 16(1)(c) of the Act.

*Held:* (i) In terms the third proviso to s. 16(1)(c) of the Income-tax Act excludes from the operation of the principal clause that *part of the income* alone which arises to any person under a deed of settlement: it does not remove from its protection the entire deed of trust, if *part of the income* is not covered by the conditions prescribed or if the settlor has in a part of the income interest direct or indirect. The third proviso does not operate to exclude the income which the settlor receives as a beneficiary from liability to tax.

(ii) The third proviso to s. 16-(1)(c) of the Act does operate in respect of settlements, dispositions, or transfers which are by the first proviso revocable for the purpose of that clause.

(iii) Two conditions are necessary for the application of the 3rd proviso to s. 16-(1)(c) of the Income-tax Act: (i) that the trust should not be revocable for a period exceeding 6 years or during the life time of the beneficiary and (ii) the settlor or disponent should have no direct or indirect benefit from the income given to the beneficiary. The effect of the two conditions is that, that part of the income which arises to any person by virtue of the settlement which is not revocable for a period of six years or which is not revocable during the life time of the beneficiary will not be included in the settlor's income, provided that from the income of such person the settlor derives no benefit direct or indirect.

On the construction of the deed of trust it was held that the deed was not revocable within six years provided by s. 16 (1)(c) of the Act.

*Ramji Keshavji v. Commissioner of Income-tax, Bombay*, 13 I.T.R. 105, relied on.

(iv) On the facts of this case it was held that by virtue of the third proviso to s. 16-(1)(c) of the Act the income received by the beneficiaries under the deed of trust other than the assessee could not until the power of revocation arose to the assessee, be deemed to be the income of the assessee for the purpose of assessment to income-tax.

**CIVIL APPELLATE JURISDICTION:** Civil Appeal No. 620 of 1963. Appeal by special leave from the judgment and decree dated 9, 1961 of the Patna High Court in M.J.C. No. 497 of 1957.

*N. D. Karkhanis and R. N. Sachthey*, for the appellant.

*Sarjoo Prasad, B. D. Singh and D. Goburdhan*, for the respondent.

April 28, 1964. The judgment of the Court was delivered by

SHAH, J.—Rani Bhuwaneshwari Kuer—hereinafter referred to as 'the assessee' was the proprietor of a seven-sixteenth share in an estate known as 'Tekari Raj', having inherited that estate from her parents. The assessee later acquired by purchase a major portion of the remaining nine-sixteenth share in the Raj. The estate held by the assessee was heavily encumbered, and with a view to arrange for liquidation of the debts the assessee executed an indenture of trust dated January 20, 1941, whereby the Tekari Raj and certain zamindari properties owned by the assessee were conveyed to certain named trustees to be held in trust, subject to conditions specified therein. The principal beneficiaries under the deed after payment of the debts were the assessee, her husband and her five sons.

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By the 23rd clause of the deed it was directed that after making certain payments, the trustees shall divide the surplus of the net rents, issues and profits thereof in the proportions set out in the clause. The 24th and the 25th clauses dealt with the devolution of the beneficial interest in the event of death of any of the beneficiaries. By the 41st clause it was provided that after the debts and liabilities set out in Sch. 'D' to the deed were paid off and discharged, the settlor shall be entitled to make a permanent trust of some of the villages demised under the deed for the maintenance and up-keep of the Tekari Forts, observance of Durga Puja and other purposes specified therein, and in the event of the settlor dying before payment and discharge of the debts and liabilities set out in Sch. 'D', and without making any permanent trust for the purposes enumerated, the settlor enjoined the trustees after discharge of the debts mentioned in Sch. 'D' to set apart property fetching a net income of Rs. 20,000/- to form the corpus of the permanent trust to meet the expenses relating to the repair of the Tekari Forts, celebration of Durga Puja and other purposes specified. By the 42nd clause it was provided that the trust under the deed shall terminate after payment of the debts and liabilities set out in Sch. 'D' or after the death of the last amongst the sons, whichever event shall last occur, and by the 43rd clause it was provided that if any of the beneficiaries under the deed or their heirs in future shall challenge the Indenture of Release and Agreement dated December 6, 1939, executed by the settlor in favour of her husband and the action taken thereunder, the said beneficiary shall on making such objection forfeit his right as a beneficiary under the deed. It was also provided that if there shall be any breach by any of the beneficiaries or of the covenants or conditions and limitations imposed under the deed, he, or she shall not be entitled to any money or to any share in the rents, issues or usufruct of the trust property and he or she shall be deemed to have been excluded from the categories of beneficiaries and his or her share of the rents, issues and profits will be dealt with or enjoyed by the settlor in her entire discretion, provided always that the settlor may at any time during her life by any deed revocable or irrevocable revoke or vary either wholly or partly the trust or any provisions of the deed, but not before the payment and discharge of the debts and liabilities as mentioned in Sch. 'D', and provided further that notwithstanding such revocation of the trust the settlement made under the deed remained good and effective subject to the forfeiture clause set out therein.

This deed was modified by a deed of rectification dated December 22, 1941, reciting that with the consent of all persons who were parties to the deed of trust, it was directed

that at any time during the lifetime of the assessee the assessee had the power to revoke or vary, either wholly or partly, the trust or any provisions of the deed of trust, but not so as to effect the payment and discharge of the debts and liabilities as mentioned in Sch. 'D' thereto and the original deed of trust shall be read and construed as if it contained a power vested in the settlor (the assessee) during her life by deed to revoke or vary, either wholly or partly, the trust or any provisions of the said trust, but not so as to effect the payment and discharge of the debts and liabilities as mentioned in Sch. 'D'.

Another deed called a deed of amendment was executed by the assessee on January 12, 1942. By this deed paragraphs 22, 32, 33, 35, 36 and 37 of the original deed were cancelled and other paragraphs including paragraphs 23, 24 and 42 were amended and modified and paragraphs 42(a), 44 and 45 were added. By the amendment of paragraph-23 the surplus rents, issues and profits of the trust property were to be divided in seven equal shares and by the amendment made in cl. 24 it was provided that in the event of the death of any of the sons, his share of the rents, issues and profits shall become payable to his heir or heirs. By the modifications in paragraph-42 it was provided that the trust under the deed may terminate after payment of the debts and liabilities of the trust that would then be outstanding or after extinguishment of the *Thicca* leases in favour of the Maharajadhiraj of Darbhanga or in favour of Capt. Maharaj Kumar Gopal Saran Narain Singh of Tekari, whichever event shall occur last. Paragraph 42(a) provided that after the provisions as laid down in para 41 had been carried out and when the last contingency set out in para 42 as modified had arisen, the beneficiaries or the heirs or successors-in-interest or representatives-in-interest of such of them as had acquired any right from any of the beneficiaries under the deed shall be entitled to partition the trust property according to their shares. The material part of paragraph-45 provided:

"That the settlement made under these presents shall be permanent, unalterable and irrevocable so far the interest created under these presents are concerned, but each beneficiary shall have full right to make any sort of arrangement about devolution or succession or make such alienation, as he may think fit, about his share, but the trust created under these presents shall be irrevocable so long the debts mentioned above including all the liabilities on the Trust property up to date are not fully paid up or discharged or so long as the *Thicca* leases in favour of Hon'ble Maharajadhiraj of Darbhanga or Capt. Maharaj Kumar Gopal

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Saran Narain Singh remain good and effective whichever event shall happen last”.

Provided that always para 43 of the Indenture of Trust dated 20th January, 1941, shall hence forth be read subject to this para.

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In proceedings for assessment for the assessment year 1947-48 the Income-tax Officer, Gaya-Palamau Circle, Gaya, rejected the contention raised by the assessee that the income under the trust was taxable in the hands of the trustees under the deed of settlement and applying the provision of s. 16(1)(c) of the Indian Income-tax Act, 1922, brought the income of the trust to tax as part of the assessee's income. The order passed by the Income-tax Officer was confirmed in appeal to the Appellate Assistant Commissioner, but the Income-tax Appellate Tribunal reversed that order. The Tribunal observed that “revocation involved taking back that which was given once, but in the present case there was nothing done by the assessee by which it could be said that she had taken back what she had given by the original deed of trust”, and the trust was therefore not a revocable trust as contemplated by s. 16 (1) (c) of the Income-tax Act.

The High Court of Judicature at Patna directed the Income-tax Appellate Tribunal under s. 66(2) of the Act to state a case and to refer the following questions:

- (1) Whether the trust created by the assessee is a revocable trust within the meaning of s. 16(1)(c) of the Income-tax Act?
- (2) Whether the income from the property which is the subject-matter of the settlement mentioned in question (1) can be deemed to be the income of the assessee under s. 16 (1) (c) of the Income-tax Act?

The High Court held that the deed of trust dated January 20, 1941 (as modified by the subsequent deed dated January 12, 1942) was within the meaning of s. 16 (1) (c) of the Income-tax Act a revocable trust, but not being revocable for six years from the date of its creation, by virtue of the third proviso to s. 16 (1) (c) which controlled not merely the substantive provisions of s. 16 (1) (c) but the first proviso to that section as well, the income received by the beneficiaries (other than the settlor) under the deed of trust was not liable to be included in the income of the assessee. The High Court accordingly directed that the income of the trust property which is the subject-matter of the settlement of the trust was not liable to be assessed to tax under the third proviso to s.

16(1)(c), but only so long as the power of revocation granted by the deed was not exercised by the assessee under the terms of the deed of trust. The High Court also declared that the assessee was liable to pay tax on the income received by her in the character of a beneficiary out of the trust properties.

Against the order passed by the High Court, with special leave, the Commissioner of Income-tax, Patna, has appealed to this Court.

The principal question which falls to be determined in this appeal is whether by the third proviso to cl. (c) of s. 16(1), income received by the beneficiaries other than the assessee is income arising to them by virtue of a settlement which is not revocable for a period exceeding six years, and from which income the assessee derives no benefit direct or indirect. Section 16(1)(c) provides:

“(1) In computing the total income of an assessee—

- (a) \* \* \*
- (b) \* \* \*

(c) all income arising to any person by virtue of a settlement or disposition whether revocable or not, and whether effected before or after the commencement of the Indian Income-tax (Amendment) Act, 1939, (VII of 1939), from assets remaining the property of the settlor or disponent, shall be deemed to be income of the settlor or disponent, and all income arising to any person by virtue of a revocable transfer of assets shall be deemed to be income of the transferor:

Provided that for the purposes of this clause a settlement, disposition or transfer shall be deemed to be revocable if it contains any provisions for the retransfer directly or indirectly of the income or assets to the settlor, disponent or transferor, or in any way gives the settlor, disponent or transferor a right to reassume power directly or indirectly over the income or assets:

Provided further that the expression “settlement or disposition” shall for the purpose of this clause include any disposition, trust, covenant, agreement, or arrangement, and the expression “settlor or disponent” in relation to a settlement or disposition shall include any person by whom the settlement or disposition was made:

Provided further that this clause shall not apply to any income arising to any person by virtue of a settlement or disposition which is not revocable for a

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period exceeding six years or during the lifetime of the person and from which income the settlor or disponent derives no direct or indirect benefit but that the settlor shall be liable to be assessed on the said income as and when the power to revoke arises to him.”

The High Court held that the deed of trust was one in which the assets remained the property of the settlor, but as the trust was not revocable for a period of six years the income received by the beneficiaries (other than the assessee) was not liable to be taxed as the assessee's income till the power to revoke arose in his favour.

The point in dispute in this appeal is about the applicability of the third proviso to s. 16(1)(c), which seeks to exempt from the operation of the principal clause income which arises to any person under the deed of settlement executed by the assessee. Two conditions are necessary for the application of the third proviso—(i) that the trust should not be revocable for a period exceeding six years or during the lifetime of the beneficiary and (ii) the settlor or disponent should have no direct or indirect benefit from the income given to the beneficiary.

Counsel for the Commissioner contended in the first instance that the third proviso to s. 16(1)(c) applied to the trust created by the assessee because in fact within six years of the date of its execution the deed was revoked, and that in any event on a true interpretation of the covenants of the deed of trust it was revocable within six years. The plea that the trust was in fact revoked within six years was never raised before the Revenue authorities, the Tribunal or even the High Court, and is plainly unsustainable. There are, it is true, certain recitals made in the deed dated September 18, 1946, executed by the assessee, which is styled “Deed for further alteration of terms & constitution of trust” by the assessee, that the liabilities referred to in Sch. ‘D’ to the deed of trust dated January 20, 1941 had been fully discharged and the beneficiaries had been, receiving the surplus rents, issues and profits according to their respective shares in the same and the settlor had by a deed of trust dated May 28, 1946 conveyed and settled a portion of her seventh share in the rents, issues and profits of the trust properties, as well as in the corpus of Shri Bhubneshwari Hari Haresh Private Trust for meeting certain expenses. But those recitals do not even *prima facie* indicate that the trust was revoked at any time. We cannot therefore entertain this new ground raised for the first time in this Court.

It may be noticed that whereas under the original cl. 43 of the deed of trust dated January 20, 1941 even though the

trust was expressly made revocable, it could not be revoked before payment of the debts and discharge of the liabilities mentioned in Sch. 'D'. By the 45th clause which was added by the deed of amendment dated January 12, 1942, the settlement made under the deed was declared permanent, unalterable and irrevocable so far as the interest created under the deed of amendment was concerned, and was also to stand irrevocable so long as the debts mentioned in Sch. 'D' and other liabilities of the trust including all the liabilities on the trust properties were not fully paid up and discharged *and so long as the leases* in favour of the Maharajadhiraj of Darbhanga or Capt. Maharaj Kumar Gopal Saran Narain Singh remained good and effective, whichever event last happened. It is conceded that the lease in favour of the Maharajadhiraj of Darbhanga was to ensure till 1965 and the lease in favour of Capt. Maharaj Kumar Gopal Saran Narain Singh till 1954. By cl. 45 of the deed of amendment the right of revocation was not exercisable till the *Thicca* leases in favour of the Maharajadhiraj of Darbhanga and Capt. Maharaj Kumar Gopal Saran Narain Singh remained good and effective, and we are unable to hold that the deed of trust was revocable within six years as provided by s. 16(1)(c) of the Act.

It was urged on behalf of the Commissioner in the alternative that the third proviso to s. 16(1)(c) did not protect the assessee against the application of the substantive part of that clause, because the assessee was deriving under the terms of the deed of trust a direct benefit. There are in the third proviso, two cumulative conditions on the existence of which the exemption from liability to have the income arising from a settlement included in the assessee's income. The effect of the two conditions is that, that part of the income which arises to any person by virtue of the settlement which is not revocable for a period of six years or which is not revocable during the lifetime of the beneficiary will not be included in the settlor's income, provided that from the income of such person the settlor derives no benefit direct or indirect. The third proviso to s. 16(1)(c) does not operate to exclude the income which the settlor receives as a beneficiary, from liability to income-tax: it merely excludes that part of the income which is under the deed of settlement given to another person from liability to tax in the hands of the settlor, if the conditions prescribed by the third proviso are fulfilled. The contention raised by the Commissioner that if under the deed of trust the settlor has reserved to himself as a beneficiary any part of the income of the property settled, the third proviso will not apply to the deed of trust runs contrary to the plain words of the statute. In terms the third proviso excludes from the operation of the principle clause that *part of the income* alone which arises to any person under a deed of

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settlement: it does not remove from its protection the entire deed of trust, if part of the income is not covered by the conditions prescribed or if the settlor has in a part of the income interest direct or indirect.

Finally, it was contended that the third proviso only operates in respect of deeds of settlement or disposition which are referred to in cl. (c), but not to deeds of settlement or disposition which by the first proviso are *deemed to be* revocable in the conditions mentioned by the first proviso. In other words, it is submitted the benefit of the proviso is not available in those cases where the settlement or disposition is deemed by the proviso to be revocable, because it contains a provision for the retransfer directly or indirectly of the income or assets to the settlor, or in any way it gives the settlor, disponent or transferor a right to reassume power directly or indirectly over the income or assets. We are unable to agree with this contention also. By the first proviso, settlements, dispositions or transfers of the character described therein, are deemed revocable for the purpose of the principal clause. The function of proviso I and proviso II is plainly explanatory. The second proviso in terms says that the expression "settlement or disposition" is to include any disposition, trust, covenant, agreement, or arrangement, and the expression "settlor or disponent" is to include any person by whom the settlement or disposition was made. Similarly the first proviso states that settlements, dispositions or transfers, if they are of the character described, shall for the purpose of the principal clause be revocable transfers. If that be the true interpretation, and we think it is, it would be impossible to hold that the third proviso does not operate in respect of settlements, dispositions or transfers which are by the first proviso revocable for the purpose of that clause.

In a case decided by the Bombay High Court *Ramji Keshayji v. Commissioner of Income-tax, Bombay*(<sup>1</sup>) Kania, J., in considering the scheme of s. 16(1)(c) observed:

"The first stage is that when there is a revocable transfer of assets, the income derived from such assets is still to be considered the income of the settlor. The law next specifies by proviso I what would be deemed a revocable transfer, in spite of the deed being apparently irrevocable. The relevant question for that proviso is this: Is this transfer revocable because it fulfils the conditions contained in the proviso? The answer to that question can be only, it is revocable, or it is not. If the answer is in the negative, no further discussion can arise

(<sup>1</sup>) 13 I.T.R. 105.

because, on the face of it, the deed is not revocable and, therefore, it does not come under Section 16(1)(c). If, however, the answer to the question is in the affirmative, the deed although ostensibly irrevocable, is deemed to be revocable, and thus becomes a revocable transfer of assets, within the meaning of the substantive provision of Section 16(1)(c). Having reached that stage, the law proceeds to consider further what is found in proviso 3. The scheme appears to be that although in fact, after reading the provisions of Section 16(1)(c) with proviso I, the transfer is revocable, the law will not still consider the income derived from such a settlement the income of the settlor, provided the settlement is not revocable for a period exceeding six years or during the lifetime of the person for whom the income is settled, and further, from which income the settlor derives no direct or indirect benefit."

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In our view that passage correctly summarises the effect of the third proviso to s. 16(1)(c).

The High Court was therefore right in holding that by virtue of the third proviso to s. 16(1)(c) of the Indian Income-tax Act, 1922, the income received by the beneficiaries under the deed of trust other than the assessee could not until the power of revocation arose to the assessee, be deemed to be the income of the assessee for the purpose of assessment to income-tax.

The appeal fails and is dismissed with costs.

*Appeal dismissed.*