

CIT vs. Manjula J. Shah - [2013] 355 ITR 474 (Bombay)¹

Where capital asset is acquired under a will or gift, indexed cost of acquisition is calculated with reference to year in which previous owner first held the asset; not the year in which assessee became owner of asset

1. Facts:

- a. The assessee sold a flat at Prabhadevi, Mumbai, on 30.06.2003 (relevant for AY 2004-05) for a total consideration of Rs. 1.10 cr. She had acquired the flat from her daughter ('previous owner') vide gift deed dated 01.02.2003.
- b. The previous owner, in turn, had acquired the said flat on 29.01.1993 at a cost of Rs. 50.48 lakhs.
- c. The assessee computed long term capital gains ('LTCG') on sale of flat considering the indexed cost of acquisition ('ICOA') for the financial year 1993-94 (year of acquisition of flat of the previous owner) and offered Rs. 20.92 lakhs as LTCG.
- d. CIT(A) as well as ITAT allowed the claim of the assessee considering indexation for 1993-94. On appeal, the following issue came before the Hon'ble High Court.

2. Issue under consideration before the Hon'ble HC

While computing the capital gains arising on transfer of a capital asset acquired by the assessee under a gift, whether ICOA has to be computed with reference to the year in which the previous owner first held the asset or the year in which the assessee became the owner of the asset?

3. Revenue's contentions

- a. Under *Explanation* (iii) to Section 48 of the ITA², ICOA has to be determined with reference to the cost inflation index ('CII') for the first year in which the asset was first

¹ SLP filed by the Revenue before the SC against the decision was recently dismissed by the SC.

² Income tax Act, 1961

held by the assessee. Since the asset was held by the assessee from 01.02.2003, CII for 2002-03 would be applicable in determining ICOA.

- b. The deeming fiction under *Explanation* 1(i)(b) to Section 2(42A) - to include the period for which the asset was held by the previous owner in the period for which the asset was held by the assessee under a gift or will - is for the limited purpose of determining as to whether the asset was held as a short term capital asset or long term capital asset and that the said fiction cannot be applied in determining ICOA in view of the express language used in *Explanation* (iii) to Section 48 of the ITA.
- c. The Revenue relied on the following decisions:
 - a. DCIT V/s. Kishore Kanungo reported in [(2006) 102 ITD 437 (Mum)]³, which held that under *Explanation* (iii) to Section 48, ICOA has to be determined with reference to CII for the first year in which the asset was held by the assessee and not with reference to CII for the first year in which the asset was held by the previous owner.
 - b. CIT V/s. Anjum M.H. Ghaswala & Ors. [252 ITR 1 (S.C.)], it was held that where the language of a statute is clear and unambiguous, one has to apply the literal interpretation and not the purposive interpretation. Accordingly, the Revenue contended that when the words used in *Explanation* (iii) to Section 48 are clear and unambiguous, it would not be proper to interpret Section 48(iii) by importing the meaning given in *Explanation* 1(i)(b) to Section 2(42A).
- d. It is not disputed by the Revenue that the assessee must be deemed to have held the capital asset from 29.01.1993 (though actually held from 1/2/2003) by applying the *Explanation* 1(i)(b) to Section 2(42A) and hence liable for LTCG tax. However, the revenue disputes the applicability of the deemed date of holding the asset from 29.01.1993 while determining ICOA under clause (iii) of the *Explanation* to Section 48.

4. Assessee's contentions

Relying on the language of Sections 48 and 2(42A), the assessee contended that ICOA has to be determined with reference to CII for the year in which the cost of acquisition was

³ This decision has been dissented in cases of M. Siva Parvathi & Ors. Vs. ITO [(2011) 7 ITR 468 (Vishakhapatnam)] and Sanjay Harichand Kumar vs. ITO [2016 49 ITR(T) 22 (Chennai - Trib.)] to name a few.

incurred. In the present case, the cost of acquisition was incurred on 29.01.1993 and, hence, cost inflation index for 1993-94 would be applicable.

5. Held:

The Hon'ble High Court dismissed the appeal of the Revenue and held in favour of the assessee making following observations:

- a. If the object of the legislature is to tax the gains arising on transfer of a capital acquired under a gift or will by including the period of holding of the previous owner in determining the period of holding of the assessee, then that object cannot be defeated by excluding the period of holding of the previous owner while determining ICOA. Thus, it is not possible to accept the contention of revenue that the fiction contained in Explanation 1(i)(b) to Section 2(42A) cannot be applied in determining ICOA u/s 48.

In other words, if LTCG has to be computed u/s 48 by treating that the assessee held the capital asset from 29.01.1993, then, naturally in determining ICOA u/s 48, the assessee must be treated to have held the asset from 29.01.1993 and accordingly CII for 1992-93 would be applicable in determining ICOA.

- b. The words of a statute are to be understood in their natural and ordinary sense unless the object of the statute suggests to the contrary. In the absence of any specific definition and any indication in clause (iii) of the *Explanation* to Section 48 that the words 'asset was held by the assessee' has to be construed differently, the said words should be construed in accordance with the object of the statute, that is, in the manner set out in *Explanation 1(i)(b)* to section 2(42A).
- c. Section 2 of the ITA expressly provides that unless the context otherwise requires, the provisions of the ITA have to be construed as provided under Section 2 of the ITA. In Section 48 of the ITA, the expression 'asset held by the assessee' is not defined and, therefore, in the absence of any intention to the contrary, the expression 'asset held by the assessee' in clause (iii) of the *Explanation* to Section 48 of the ITA has to be construed in consonance with the meaning given in Section 2(42A) of the ITA.
- d. Section 55(1)(b)(2)(ii) provides that where the capital asset became the property of the assessee by any of the modes specified u/s 49(1), not only the cost of improvement

incurred by the assessee but also the cost of improvement incurred by the previous owner shall be deducted from the total consideration received by the assessee while computing the capital gains u/s 48. Thus, same analogy has also to be applied in determining ICOA in the hands of the assessee.

- e. The High Court relied on CBDT Circular No.636 dated 31/8/1992 [198 ITR 1 (St)] stating that a fair method of allowing relief by way of indexation is to link it to the period of holding the asset. Thus, if indexation is linked to the period of holding the asset and in the case of an assessee covered u/s 49(1), the period of holding the asset has to be determined by including the period for which the said asset was held by the previous owner, then obviously in arriving at the indexation, the first year in which the said asset was held by the previous owner would be the first year for which the said asset was held by the assessee.

6. **Comments:**

The issue of allowance of indexed cost of acquisition while computing capital gains with respect to the period of holding of the previous owner has been a contentious issue. Similar issue had arisen in other cases, such as CIT vs. Smt. Asha Machaiah⁴, CIT v. Smt. Kaveri Thimmaiah⁵, ITAT vs. Nandlal R. Mishra⁶, ITAT vs. Smt. Nita Narendra Mulani⁷ to name a few. With the recent dismissal of SLP on said issue by the Hon'ble Supreme Court, hopefully, the said controversy can now be considered to be settled. Indeed, not attributing indexed cost to the period of holding of the previous owner has huge ramifications on the capital gains tax liability of the assessee as demonstrated in the Annexure.

Further, said decision would also help in claiming indexed cost of acquisition even in case of other transactions such as amalgamation, demerger, conversion, etc. where the period of holding of the previous owner is deemed to be included in the period of holding of the assessee under *Explanation* to section 2(42A) of the ITA.

⁴ [2014] 227 Taxman 155 (Karnataka)(MAG.)

⁵ [2014] 369 ITR 81 (Karnataka)

⁶ [2015] 155 ITD 306 (Mumbai - Trib.)

⁷ [2018] 172 ITD 169 (Mumbai - Trib.)

Annexure: Example demonstrating computation of ICOA as per the assessee and as per the revenue's contentions

Facts	Financial year	Indexation
Purchase of flat by previous owner	2002-03	105
Gift of flat	2013-14	220
Sale of flat	2017-18	272
		Rs. In cr
Sale Price		100.00
Purchase Price of previous owner		25.00

Calculation of LTCG as per	Assessee	Revenue
	Rs. In cr	
Sale price	100.00	100.00
Cost of acquisition	25.00	25.00
Year of acquisition*	2002-03	2013-14
Indexed cost of acquisition	64.76	30.91
	(25*272/105)	(25*272/220)
Long term capital gains	35.24	69.09
Tax @ 20%	7.05	13.82
* for indexation only		