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Analysis of Family Settlement aka Family Arrangement

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Introductory Remarks

1. Family Settlement or Family Arrangement, as it is also called, is a device by which disputes between family members as to their respective property rights are settled. Such settlement may involve division of the property as between them and consequently a release of rights by one or the other in favour of the allottees. Conflicting legal claims get so settled. Since the settlement only defines a pre-existing joint interest as separate interests, there is no conveyance, if the arrangement is *bona fide.* ***Such arrangements are recognized even under the English law and for all communities irrespective of their personal laws. Since there is no conveyance, there is no need for registration of such arrangements, when orally made, even if later reduced to writing.***

In this presentation this concept has been covered in an exhaustive way starting with the principles explained by the Supreme Court in quite a few celebrated decisions in the most illuminating way, if one may be permitted to say so.

Let us start the discussion by referring to one of the illuminating decisions of the Apex Court in the case of *Maturi Pullaiah vs. Maturi Narasimham A.I.R. 1966 S.C. 1836.*

Decision of the Supreme Court in the case of Maturi Pullaiah (supra)

2. The Supreme Court in the case of *Maturi Pullaiah (supra)* referred to the principles encompassing the concept of "Family Arrangements" in the following words at para.9 of its order-

"A brief summary of the nature of family arrangements and the conditions for their validity is found in Halsbury's Laws of England, 3rd Edn., Vol. 17 at pp. 215-216:

A family arrangement is an agreement between members of the same family, intended to be generally and reasonably for the benefit of the family either by compromising doubtful or disputed rights or by preserving the family property for the peace and security of the family by avoiding litigation or by saving its honour.

The agreement may be implied from a long course of dealing, but it is more usual to embody or to effectuate the agreement in a deed to which the term 'family arrangement' is applied."

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The principles the Courts should bear in mind in appreciating the scope of such family arrangement are stated thus:

> "Family arrangements are governed by principles which are not applicable to dealings between strangers. The Court, when deciding the rights of parties under family arrangements or claims to upset such arrangements, considers what in the broadest view of the matter is most for the interest of families, and has regard to considerations which, in dealing with transactions between persons not members of the same family, would not be taken into account. Matters which would be fatal to the validity of similar transactions between strangers are not objections to the binding effect of family arrangements

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This passage indicates that even in England Courts are averse to disturb family arrangements but would try to sustain them on broadest considerations of the family peace and security. This concept of a "family arrangement" has been accepted by Indian Courts but has been adapted to suit the family set up of this country which is different in many respects from that obtaining in England. As in England so in India, Courts have made every attempt to sustain a family arrangement rather than to avoid it, having regard to the broadest considerations of family peace and security."

Decision of the Supreme Court in the case of *Krishna Biharilal vs. Gulabchand [1971] AIR1971 SC 1041*

3. The Supreme Court in the case of *Krishna Biharilal (supra)* succinctly explained the term "family arrangement" in the following words at para.4 of its judgment-

"To consider a settlement as a family arrangement, it is not necessary that the parties to the compromise should all belong to one family. As observed by this Court in Ram Charan Das vs. Girjanandini Devi AIR 1966 SC 323 the word "family" in the context of a family arrangement is not to be understood in a narrow sense of being a group of persons who are recognised in law as having a right of succession or having a claim to a share in the property in dispute.

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If the dispute which is settled is one between near relations, then the settlement of such a dispute can be considered as a family arrangement-see Ram Charan Das's case (supra). The Courts lean strongly in favour of the family arrangements to bring about harmony in a family and do justice to its various members and avoid in anticipation future disputes which might ruin them all-see Sahu Madho Das and others. vs. Pandit Mukanel Ram and another [1955] AIR 1955 SC 481."

A brief note on how principles of Family Settlement defined in Law of England

4.Family Settlement and underlying principles are defined in the Law of England (Vol.17) 3rd Edition at page-215-216) as under:

"A family arrangement is an agreement between members of the same family, intended to be generally and reasonably for the benefit of the family either by compromising doubtful or disputed right or by preserving the family property or the peace and security of the family by avoiding litigation or by saving its honour".

"The agreement may be implied from a long course of dealing, but it is more usual to embody or to effectuate the agreement in a deed to which the term family agreement is applied".

Propositions laid down by the Supreme Court in the celebrated decision in the case of *Kale vs. Deputy Director of Consolidation [1976] 3 SCC 119*

5. The concept of Family Settlement was considered by the Supreme Court in detail in the case of Kale(supra) and the Supreme Court explained the binding effect and the essentials of a family settlement in a concretised form and reduced the concept of Family Settlement into the following propositions:

(1) *The family settlement must be a bona fide one so as to resolve family disputes and rival claims by a fair and equitable division or allotment of properties between the various members of the family;*

(2) *The said settlement must be voluntary and should not be induced by fraud, coercion or undue influence:*

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(3) The family arrangement may be even oral in which case no registration is necessary;

(4) It is well-settled that registration would be necessary only if the terms of the family arrangement are reduced into writing. Here also,a distinction should be made between a document containing the terms and recitals of a family arrangement made under the document and a mere memorandum prepared after the family arrangement had already been made either for the purpose of the record or for in formation of the court for making necessary mutation. In such a case the memorandum itself does not create or extinguish any rights in immovable properties and therefore does not fall within the mischief of s.17(2) of the Registration Act and is, therefore, not compulsorily registrable;

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(5) The members who may be parties to the family arrangement must have some antecedent title, claim or interest even a possible claim in the property which is acknowledged by the parties to the settlement. Even if one of the parties to the settlement has no title but under the arrangement the other party relinquishes all its claims or titles in favour of such a person and acknowledges him to be the sole owner, then the antecedent title must be assumed and the family arrangement will be upheld and the Courts will find no difficulty in giving assent to the same;

(6) Even if bona fide disputes, present or possible, which may not involve legal claims are settled by a bona fide family arrangement which is fair and equitable the family arrangement is final and binding on the parties to the settlement.

The Supreme Court made the following important observations at earlier part of this decision—

"In Tek Bahadur Bhujil vs. Debi Singh Bhujil and others [1966] AIR 1966 SC 292 [a Bench consisting of 4 Hon'ble Judges] it was pointed out by this Court that a family arrangement could be arrived at even orally and registration would be required only if it was reduced into writing. It was also held that a document which was no more than a memorandum of what had been agreed to did not require registration. This Court had observed thus:

"Family arrangement as such can be arrived at orally. Its terms may be recorded in writing as a memorandum of what had been agreed upon between the parties.

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The memorandum need not be prepared for the purpose of being used as a document on which future title of the parties be founded. It is usually prepared as a record of what had been agreed upon so that there be no hazy notions about it in future. It is only when the parties reduce the family arrangement in writing with the purpose of using that writing as proof of what they had arranged and, where the arrangement is brought about by the document as such, that the document would require registration as it is then that it would be a document of title declaring for future what rights in what properties the parties possess.""

Cases wherein genuineness of family settlement *vis-à-vis genuineness of transactions was accepted*

6.1 The ITAT Delhi Bench in the case of Govind Kumar Khemka vs. Asstt. CIT [2020] 113 taxmann.com5/118 ITD 586 held that where the assessee had received property from his brothers on account of Family Settlement and Release Deed was also executed in which it was nowhere recorded that the assessee paid any consideration to his other three brothers, there being no commercial transaction, provisions of section 56(2)(vii)(b) of the Act were not attracted.

As per the provisions of section 56(2) of the Act, income which is not chargeable to tax under any other head of income and which is not to be excluded from the total income shall be chargeable to tax as residuary income under the head " Income from Other Sources."

6.2 In the case which arose before the ITAT Agra in Dy. CIT vs. Arvind Kapoor [IT Appeal No. 280 of(Agra) 2013]- Assessment Year 2008-09- Date of order 10th February, 2016 Agra Trib, the Assessing Officer on noticing that there was a credit of Rs. 5 crores asked the assessee to explain the source of credit to which the assessee explained that it was received on family settlement. After going through the document submitted by the assessee titled "Recording of Family Settlement" that the assessee had relinquished his share in family business and in lieu thereof he received Rs. 5 crores, the Assessing Officer held that provisions of section 2(47)(v) of the Act stood attracted and accordingly framed the assessment.

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The Commissioner of Income-tax (Appeals) after apprising the facts of the case noted that genuine Family Settlement was done with a view to settling the issue(s) between the assessee, his brother and mother and therefore through family settlement deed, the family business was settled and all disputes were settled in the presence of their family Guru. The Commissioner of Income-tax (Appeals) thus, on appreciation of evidences and material, held that family settlement was genuine and was done under circumstances to settle all disputes between family members.

The Tribunal held that the Commissioner of Income-tax (Appeals) was justified in holding that no capital gain tax was attracted in this case and so the addition by the Assessing Officer was unjustified.

The Tribunal followed number of precedents in this case.

6.3 The Bombay High Court in the case of Asstt.CIT vs Kamlakar Moghe [2015] 64 taxmann.com 413[2016] 236 Taxman 439/[2015] 378 ITR 561 held that where the assessee received a property with a clause in his mother's Will providing overriding title in favour of his three sisters, payment made by assessee to his sisters for acquiring absolute title in property would be reduced as expenditure while computing capital gain on sale of said property.

6.4 The ITAT Mumbai Bench in the case of Dy. CIT vs Paras D. Gundecha [2015] 62 taxmann.com 170/155ITD 880 noted that the assessee, in this case, received certain sum from his brother's wife, 'N' and claimed the said sum to be exempt under section 56(2)(v) of the Act. In her statement, 'N' stated that she gave the amount to the assessee because of family settlement deed arrived at among family members. The Assessing Officer added the amount to the income of the assessee. The Tribunal Court held that since the assessee received the sum out of family settlement, the same was not taxable, as by way of settlement only respective shares were determined.

6.5 The Andhra Pradesh and Telangana High Court in the case of P. Shankaraiah Yadav (HUF) vs. ITO[2015] 59 taxmann.com 263/232 Taxman 757/371 ITR 386 explained the concept of family settlement by observing as under at para.10 of its judgment-

> "The family arrangement is a typical legal phenomenon that does not fit into those which are specifically recognised under law. The transfer of immovable or movable property, as the case may be, does take place under the arrangement but it is substantially different from the one that is contemplated under the Transfer of Property Act or the Sale of Goods Act. No formal registered document is executed and the nature of consideration is not amenable to any legal analysis. The purport of the family arrangements was explained by the Supreme Court in Kale's case (supra), in such a way that is difficult to put it in any different words. The relevant portion reads-

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"Before dealing with the respective contentions put forward by the parties, we would like to discuss in general the effect and value of family arrangements entered into between the parties with a view to resolving disputes once for all. By virtue of a family settlement or arrangement members of a family descending from a common ancestor or a near relation seek to sink their differences and disputes, settle and resolve their conflicting claims or disputed titles once for all in order to buy peace of mind and bring about complete harmony and goodwill in the family. The family arrangements are governed by a special equity peculiar to themselves and would be enforced if honestly made. In this connection, Kerr in his valuable treatise Kerr on Fraud at page 364 makes the following pertinent observations regarding the nature of the family arrangement which may be extracted thus:

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’The principles which apply to the case of ordinary compromise between strangers do not equally apply to the case of compromises in the nature of family arrangements. Family arrangements are governed by a special equity peculiar to themselves, and will be enforced if honestly made, although they have-not been meant as a compromise but have proceeded from an error of all parties, originating in mistake or ignorance of fact as to what their rights actually are, or of the points on which their rights actually depend.””“

The issue was thus decided in favour of the assessee.

6.6 The ITAT Chennai Bench in the case of SKM Shree Shivkumar vs. Asstt.CIT [2014] 48 taxmann.com346/65 SOT 232 held that where pursuant to a family settlement, the assessee received certain amount and assets from a company in which he had substantial interest, the provisions of section 2(22)(e) of the Act could not be applied to such amount so received.

The Tribunal made the following pertinent observations at para.12 of its order-

"In the provisions of the taxing Statute, piercing the corporate law is also a recognized phenomenon. Section 2(47)(vi) of the Act is one such provision which includes a transaction as a transfer when on becoming a member of, or acquiring shares, in a co-operative society, company or other Association of Persons, or by way of any agreement, or any arrangement or in any other manner whatsoever which has the effect of transferring, or enabling the enjoyment of immovable property will be considered as a transfer.

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Further section 47(i) of the Act also makes it clear that any distribution of capital assets on total or partition of Hindu Undivided Family cannot be treated as transfer for the purpose of computing capital gains. When this being the case, in our considered view the assessee should also get the benefit of piercing the corporate veil of the wholly owned family companies while determining his tax liability for viewing the true nature of the entire transactions. Moreover, with regard to applicability of section 2(22)(e) of the Act, it is relevant to note that if the family settlement had not taken place there was a peril for the dissolution of the family-owned companies for the sake of partition. In order to prevent such a precarious situation, the assets of the family-owned companies had to be realigned. Thus, there was a commercial exigency for the family-owned companies to transfer some of its assets and liquid assets in order to avoid extinction.

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Thus, from the overall facts and circumstances of the case, it is held that the entire transactions between the family members and their wholly owned companies were due to the family arrangement/partition or settlement etc. and also the provisions of section 2(22)(e) of the Act would not apply following the various decisions of higher judiciary. Having held so, provisions of section 2(24)(iv) of the Act will also not be applicable to the case of the assessee in these circumstances."

6.7 The facts in the case decided by the Allahabad High Court in CIT vs Vajra Investment & Trading Co. Ltd. [IT Appeal No. 176 of 2005] Assessment Year 1994-95-Date of decision- 25th October,2013 were that during the assessment year under consideration on account of family settlement between O Group and M Group shares were

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purchased by the assessee company at Rs. 23.21 per share being group company's member and the Assessing Officer opined that the market rate was Rs. 300 per share. According to the Assessing Officer, while M had sold shares to the company Group, to which the assessee company belonged, it amounted to unaccounted transaction and the Assessing Officer stated that the assessee had paid extra price outside the books for purchasing these shares. The Assessing Office, by taking into account the difference between cost of acquisition of shares by assessee and market price of shares of M, added such difference to the total income. The Commissioner of Income-tax (Appeals) deleted the addition which was confirmed by the Tribunal

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The Allahabad High Court, on perusal of records, noted that it appeared that there was family settlement and the settlement between O and M groups was according to terms and conditions settled between them and that family settlement of transfer of shares for lower price can be for number of considerations and the prime consideration, in this case, was to have peace in all the families involved in the dispute. The High Court also noted that these two groups belonged to O family and were fighting each other since long and finally, dispute was resolved by the Company Law Board.

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The High Court, agreeing with the views of the Tribunal held that there was no question of paying any extra money to other group outside the books and as the Assessing Officer made addition only based on presumption, surmises and conjunctures and was not based on cogent material on record, there was no reason to interfere with the order passed by the Tribunal.

6.8 The Karnataka High Court in the case of CIT vs. R. Nagaraja Rao [2012] 21 taxmann.com 101/207Taxman 236/[2013] 352 ITR 565 held that where family members of assessee were holding shares in different business concerns and assessee under a family arrangement had transferred his share held in a firm in favour of a family member, there was no transfer involved attracting the provisions of section 2 (47)(v) of the Act in the instant case.

6.9 The facts obtaining in the case decided by the Punjab & Haryana High Court in CIT vs. Ashwani Chopra[2013] 30 taxmann.com 299/213 Taxman 490/352 ITR 620 were that during the course of assessment proceedings, the Assessing Officer found that the assessee (Group A) had received compensation from Group B at the time of partition of properties of group of 'H' Ltd and that the said amount had been kept infixed deposits as per the orders passed by the High Court as well as by the Supreme Court. The Assessing Officer considered the family settlement and found that 8.56 per cent of Rs. 24 crores of compensation was the share of the assessee and, consequently, levied long term capital gain tax on the said amount.

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On appeal, the Commissioner of Income-tax (Appeals) set aside the order of the Assessing Officer and the order of the Commissioner of Income-tax (Appeals) was confirmed by the Tribunal

The matter reached the Punjab and Haryana High Court.

The Revenue argued that the orders of the Commissioner of Income-tax (Appeals) and the Tribunal were based upon misapprehension of facts and law, therefore, the capital gain was payable on the amount of compensation received.

The assessee relying upon the 'principle of owelty', argued that the amount of compensation received by the assessee was to equalize the inequalities in the partition and, thus, such amount was nothing but an immovable property. It was contended that such amount received by the assessee was not an income, but a share in the immovable property though paid in cash, as it was the cash value to settle inequalities in partition. Therefore, such amount could not be treated as income liable to capital gain.

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The question identified by the Court to be answered by it was as under—

Whether amount of owelty i.e., compensation deposited to equalize partition represents immovable property and would attract capital gain tax?

The High Court held as under—

> "The payment of Rs. 24 crores to Group A is to equalize the inequalities in partition of the assets of 'H' Ltd. The amount so paid is immovable property. If such amount is to be treated as income liable to tax, the inequalities would set in as the share of the recipient will diminish to the extent of tax. Since the amount paid during the course of partition is to settle the inequalities in partition, it is deemed to be immovable property. Such amount is not an income liable to tax. Thus, the amount of owelty i.e.compensation deposited by Group B, is to equalize the partition represents immovable property and will not attract capital gain.

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With regard to the argument that the assessee is liable to tax being interest on cash, suffice it to say, that such question or fact does not arise from the orders of the Tribunal. Consequently, it is held that the amount of compensation paid to the assessee to settle inequalities in partition, thus, a provision of owelty, represents immovable property and is not an income exigible to tax.“

"Owelty" means the difference which is paid or secured by one coparcener to another, for the purpose of equalizing a partition: a lien created or a pecuniary sum paid by order of the Court to effect an equitable partition of property (as in divorce) when such a partition in kind would be impossible, impracticable, or prejudicial to one of the parties. In other words, it is a payment to balance (both) sides involved in a dispute

6.10 The Bombay High Court in the case of CIT vs. Chemosyn Ltd. [2015] 64 taxmann.com 219/[2016] 236Taxman 202/371 ITR 427 held that due to difference between groups, if the assessee company was directed to buy 34 per cent of shareholding of one of warring groups, it had to be inferred that the said expenditure was incurred only to enable smooth running of the business and so it was a deductible expenditure.

The following paragraphs from the decision of the Bombay High Court clearly bring out the facts in the case as well as decision by various authorities—

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"Para 9. . . . . with regard to the nature of expenditure, the brief facts are that there was a dispute between brothers who together owned the respondent-assessee company. As a consequence of differences between the two groups, the dispute reached the Company Law Board as well as the Supreme Court of India. Thereafter, a settlement was arrived at between the two warring groups of shareholders and as per directions of the Company Law Board, the assessee-company was directed to buy 34 % shareholding of one of the warring groups and cancel the same. The respondent-assessee had claimed before the Assessing Officer that the amount of Rs. 6.81 crores (being the difference between consideration paid and face value of the shares acquired for cancellation) was revenue expenditure.

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This on the basis that in view of the dispute between its shareholders, the business was adversely affected and therefore, the payment was expected to be incurred for purposes of business. However, the Assessing Officer did not accept the same and held the expenditure to be of capital nature and disallowed the claim of revenue expenditure.

Para.10- On appeal, the Commissioner of Income-tax (Appeals) did not accept the respondent-assessee's contention and upheld the order of the Assessing Officer. On further appeal, the Tribunal by the impugned order set aside the order of the Assessing Officer and the Commissioner of Income-tax(Appeal)'s orders by placing reliance upon its decision in Echjay Industries Ltd. vs. Deputy CIT [2004]88 TTJ 1089 (Mum.) wherein on identical facts and circumstances, the expenditure incurred by the assessee company to purchase its shares was held to be deductible as revenue expenditure.

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An appeal from the order of the Tribunal in Echjay Industries Ltd. (supra) was also dismissed by this Court .Besides, the Tribunal records a finding of fact that in view of the dispute between the two warring groups of shareholders the business of respondent assessee had suffered. It records that the total sales of the respondent-assessee which was in the range of Rs. 20 to 25 crores per annum during the pre-dispute period had come down to around Rs. 9 crores in the financial year 1999-2000 when dispute arose and remained in the range of Rs. 10 to 14 crores during the period of litigation between its two groups of shareholders spanning over six years. It also records that after the settlement of dispute in the financial year 2005-06 there was a substantial increase in the sales touching nearly Rs. 18 crores per annum. The impugned order of the Tribunal also notes that after settlement of the dispute new products were launched by the respondent-assessee-company. All this was evidence of the fact that the dispute between two groups of shareholders had affected the business of the company.“

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The High Court based on these facts held that "the impugned order records a finding of fact that the amounts which were paid by the respondent assessee for the purpose of purchase of its shares, to its shareholder for subsequent cancellation was an expenditure incurred only to enable smooth running of the business. Thus, the expenditure was incurred for carrying on its business smoothly and therefore, was a deductible expenditure. Thus, the impugned order of the Tribunal is essentially a finding of fact. The respondents have not been able to show that these findings are in any manner perverse or arbitrary.“

The High Court, finally, dismissed the appeal of the Revenue by holding that "no substantial question of law arose on the issue referred to."

6.11 The Madras High Court in the case of CIT vs. Shanthi Chandran [2003] 127 Taxman 475 (Mad.) after setting out the provisions of section 49 of the Act held that “that in a partition, the consideration for the partition is the mutual relinquishment of the rights of the parties in the joint family properties in which each has a share. The fact that the daughters had a right to maintenance and marriage expenses and would have been entitled to a share at a partition did not render the value of the shares allotted to them under a settlement deed, the price for which they had sold or relinquished their rights over the properties. The family settlement in this context was analogous to a partition. It was the cost to the previous owner that was to be taken into account as the cost of acquisition of shares and not the amounts mentioned in the family settlement deed by the settlor.”

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This decision of the Madras High Court in the case of Shanthi Chandran (supra) was followed by the ITAT Delhi Bench in the case of Asstt. CIT vs.Baldev Raj Charla[2009] 121 TTJ 366 (Delhi) wherein the Tribunal held that “where property acquired in 1966 was received by the assessee in a family settlement, since the family settlement is analogous to a partition, clause (i) of section 49(1) was directly applicable and in such a case assessee was entitled to take into account indexed cost of acquisition by taking property’s fair market value as on 1-4-1981 “

6.12 The facts that arose in the case decided by the ITAT Bangalore Bench in Mrs. P. Sheela vs. ITO [2009]120 ITD 159 (Bang) were that consequent to differences between the two-family groups, a situation had developed requiring the two-family groups to identify their interests with clear understanding that they would not dabble in the affairs of the other family group. The assessee, daughter of R had to handover shares and other securities etc., in companies to M Group. From that point of view, the assessee being a member of R Group, had to be roped in and she had to abide by the award of the arbitrator for the sole purpose of ensuring peace between the two-family groups. Notwithstanding the fact that the assessee was a married woman, and became a member of husband's family by virtue of marriage, the antecedence with R's family remained intact and family ties were not severed.

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She, being part of R's family and carrying that name still as a daughter of the family, with a view to ensure peace and amity for her parents, had to necessarily surrender her interest in A Ltd., by giving away the shares at the price determined by the arbitrator.

The Tribunal based on these facts held that "the amount received by the assessee on transfer of various shares in the course of the family arrangement would not result in any capital gains within the meaning of the (Income-tax) Act as it did not amount to transfer."

The principles laid down by the Supreme Court in the cases of Ram Charan (supra) and Kale (supra) were followed.

6.13 The Madras High Court in the case of CIT vs Kay Arr Enterprises [2008] 299 ITR 348 (Madras) relying on its earlier decisions in the cases of CIT vs. R. Ponnammal [1986] 28 Taxman 26 (Mad) and CIT vs. AL. Ramanathan [2003] 128 Taxman 87 (Mad.) and the well-known decisions of the Supreme Court in the cases of Kale (supra) and Maturi Pullaiah (supra) held that " re-arrangement of shareholdings in company to avoid possible litigation among family members is a prudent arrangement necessary to control company effectively by major shareholders to produce better prospects and active supervision and in case of such rearrangement of shareholding, it cannot be held that there is transfer of shares liable to capital gains tax."

It is to be stated that the Supreme Court vide SLP(C) No. 18050 of 2008-Date of judgment 18th July,2008 dismissed the SLP preferred by the Revenue against the judgment of the Madras High Court in the case of Kay Arr Enterprises(supra) -Refer CIT vs. R.Jayanthi [2008] 306 ITR (St) 5

6.14 In the case which arose before the ITAT Mumbai Bench in the case of Ketan Bolinjkar vs. Asstt. CIT [2004] 2 SOT 868 (Mum.) the facts were that the assessees, two brothers, had one-third share in a property. The third co-owner in the property was their other brother. The assessees had sold their one-third ownership rights in the property and filed returns declaring capital gains thereon. In the returns, the assessees claimed certain amount paid to their sister for vacating the premises in order to sell the said property and also claimed exemption under section 54 of the Act. The Assessing Officer being of the view that the three co-owners collectively constituted a Body of Individuals framed the assessment on substantive basis on both the brothers as Body of Individuals. The Assessing Officer accepted the calculation of capital gains but disallowed the amount paid to the sister and further denied exemption under section 54 of the Act.

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The Tribunal, on second appeal by the assessee, held as under-

"In respect of payment made to the sister, the lower authorities had banked upon the Will, dated 3-12-1978, which provided that the sister would have no right in the impugned house property. She was given another flat, which was tenanted. According to them, once she had no right in the Will, she had no right to receive any compensation. Besides, she had signed an affidavit before the High Court to that effect at the time of taking probate. There were many other important facts attached to the whole episode. Since the other house given to the sister was tenanted, and since beginning she was residing with other family members in the house in question and as the period of stay was more than 12 years there was a possibility that she could have claimed right to property by way of adverse possession in case of a dispute. Her stay in the house was not doubted. The assessees agreed to sell the house with a condition that the same could be sold in vacant possession.

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The Will was not probated (author-seems to be contrary to earlier statement in the earlier part of this para as if steps were taken for probating the Will); to effect the sale, the same was necessary. The brothers anticipated the situation and a family settlement was arrived at providing that the sister could be given certain amount out of the sale proceeds of the house being sold for vacating the portion of the property occupied by her peacefully. The sister subsequently bought another flat out of the money received and shifted there. After family settlement, probate was applied in the course of which the sister signed an affidavit agreeing to the terms of probate according to Will. The swearing of affidavit on the part of the sister could not be questioned as she had the support of family settlement, which was duly executed. She did her part of performance in probate proceedings as agreed in family settlement terms.

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There was a strong possibility that the sister because of her having possession of portion of the house and family settlement, constituted an encumbrance on the property in question and, therefore, any payment given to clear the same was a deductible expenditure from sale proceeds for computation of capital gains. Therefore, the assessees were entitled to reduce the amount paid to the sister in their respective hands in that behalf."

One of the decisions referred to on behalf of the assessee and followed by the Tribunal was the one rendered by the Supreme Court in the case of *Kale (supra).*

6.15 The facts of the case which arose before the ITAT Hyderabad in ITO v. Smt. Jagrani Bai [1990] 34 ITD 54 (Hyd.) were that during the assessment year 1981-82 the assessee-lady settled her self- acquired immovable property on her minor children by a registered settlement deed, which, however, did not refer to family dispute and was also witnessed by her husband. During the assessment proceedings she filed an affidavit stating that this was done by her because of her husband having extra-marital relations with other ladies and his second marriage.

The Tribunal held that it was assessee's moral and legal obligation to support minor children and in view of her husband having deserted her, alienation of property by her was to be construed as family settlement and not a transfer so as to attract the provisions of section 64(1)(v) of the Act.

The provisions of section 64(1)(v) at the relevant point of time stood as under-

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(1) In computing the total income of any individual, there shall be included all such income as arises directly or indirectly—

(v) subject to the provisions of clause (i) of section 27, in a case not falling under sub-clause (iii) of this sub-section, to a minor child (not being a married daughter) of such individual, from assets transferred directly or indirectly to the minor child by such individual otherwise than for adequate consideration.

The Revenue's appeals were dismissed.

6.16 In the case which arose before the ITAT Delhi in ITO vs. Smt. Sharda Seshadri [1986] 16 ITD 615 (Del.) the assessee lady acquired certain jewellery under a compromise decree and later the said jewellery was sold. The Assessing Officer invoked the provisions of section 49(1)(iii) of the Act as the said jewellery, in the opinion of the Assessing Officer, was acquired by succession / inheritance.

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The Tribunal, agreeing with the views of the Commissioner of Income-tax (Appeals) held that jewellery having been acquired under a family settlement, its cost for the purposes of capital gains would be the market price prevailing on the date of acquisition of assets and provisions of section 49(1)(iii) of the Act were not, therefore, invokable on the facts of the case

It is to be noted that as per the provisions of section 49(1)(iii) of the Act where the capital asset becomes the property of the assessee by succession, inheritance or devolution the cost of the acquisition of the assets hall be deemed to be the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be.

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The Tribunal explained the concept of family settlement succinctly in the following words at para.21 of its judgment—

"21. The transaction of a family settlement entered into by the parties who are members of a family bona fide to put an end to the dispute among themselves, is not a transfer. It is not also the creation of an interest. For, in a family settlement each party tabs a share in the property by virtue of the independent title which is admitted to that extent by the other parties. Every party who tabs benefit under it need not necessarily be shown to have, under the law, a claim to a share in the property. All that is necessary to show is that the parties are related to each other in some way and have a possible claim to the property or a claim or even a semblance of a claim on some other grounds as, say, affection. These are the observations of the Hon'ble Supreme Court in the case of Ram Charan Das (supra)."

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6.17 The facts of the case which arose before the ITAT Chandigarh in T.S. Madan vs. ITO [1982] 13 TTJ 575 were that the assessee and his wife jointly purchased a plot and constructed a house property thereon. The assessee's case was that he had thrown his share into the common hotchpot of his HUF consisting of himself, his wife and son and later by family settlement as decreed by a Civil Court he became entitled 1/3 of the property in question and as such 1/3rd of income alone could be included in his hand. The Assessing Officer however included 2/3rd share of the income in his hand on the basis of investment made by the assessee and his wife for the construction of the property which worked out to be 78:22. It was undisputed that the Civil Court decreed that assessee was entitled to only 1/3rd share of the property. The Assessing Officer, however, held that the decree was collusive and brought to tax 2/3rd share of income in the hands of assessee.

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The Tribunal held that the decree of the Civil Court was binding on the Revenue unless the same was challenged and found to be collusive and that no challenge having been brought about by the revenue, though it had suspected the genuineness of the decree, it could tax only 1/3rd of the income in the hands of the assessee.

6.18 Anjappar Chettinad A/c Restaurant vs. Asstt. CIT [IT Appeal No 606 (Chny)of 2018] Assessment Year2014-15- Date of order 6th August,2018

The members of the family were partners of the partnership firm which was running a popular restaurant. The business was established by A (in whose name the business was run), the father of the present partners of the firm. There was some misunderstanding among the family members after the death of A and they intended to settle the issue. R, the eldest son of Late A was willing to retire from the partnership firm. R Inherited right in the firm by way of succession on the death of his father A, like other partners. The business of the assessee-firm thus had to be divided among the legal heirs of Late A.

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The assessee-firm received royalty from various third parties for allowing them to run the restaurant in the overseas countries. Instead of dissolving the business of partnership firm, the family members of A decided to pay monetary compensation to R who was willing to retire from the partnership firm as a partner and rest of the members of the family who were partners in the erstwhile firm wanted to continue the partnership business of the family. Accordingly, R was paid a sum of Rs. 203.40 lakhs and his wife V was paid Rs. 22.60 lakhs making a total of Rs. 226 lakhs. In short 90% of the total amount of Rs. 226 lakhs viz.Rs. 203.40 lakhs was paid to the ex-partner R and the balance of 10% on Rs. 226 lakhs viz. Rs. 22.60 lakhs was paid to his wife V and the firm claimed this amount as allowable expenditure in its books of accounts which claim was denied by the Assessing Officer and such a disallowance made by the Assessing Officer was confirmed by the Commissioner of Income-tax (Appeals).

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The assessee filed an appeal before the Tribunal.

The following submissions were made on behalf of the assessee.

(a)The assessee was a partnership firm consisting of family members and to avoid dispute among family members who were partnersan amicable solution was arrived at by way of family settlement as a result of which R agreed to retire from the firm on payment of Rs. 203.40 lakhs to him and Rs. 22.60 to his wife V on his account.

(b) As the payment related to family settlement in the sense that it was paid based on the understanding arrived between the family members, the payment did not partake the character of royalty invoking TDS provisions and.

(c) The distribution of asset and compensation paid by the assessee to one of the family members who agreed to retire from the partnership firm, a family business, could not be construed as transfer and therefore, the expenditure had to be allowed while computing the total income of the assessee.

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Rebutting these arguments, it was submitted by the Revenue as under—

(i) As the payment made to the retiring partner and his wife was in the name of royalty, such payment attracted the provisions relating to TDS and in spite of reminders no reply was forth coming from the assessee refuting the claim of the Revenue that the payment to the ex-partner who retired was royalty in nature subject to TDS and.

(ii) It was explained by the assessee, when further questioned, that the payment of Rs. 226 lakhs was made out of royalty amount of Rs. 380.72 lakhs received from overseas franchisee(s) and this receipt (of Rs. 380.72 lakhs) represented amount received for using the name of the assessee-firm which has registered its Trademark. So, the amount of Rs. 226 lakhs paid was nothing but royalty and as there had been violation of provisions relating to TDS the expenditure claimed was not allowable in full.

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Author's note- It is to be noted that the assessment year concerned in this case was 2014-15 which provided for full disallowance under section 40(a)(ia) of the Act, as the section stood then, and restricting the disallowance to 30% has been introduced only with effect from assessment year 2015-16 by the Finance(No.2) Act, 2014

The Revenue therefore prayed that "the so-called expenditure claimed by the assessee-firm as deduction was neither relatable to the business nor their royalty, therefore, the Assessing Officer rightly disallowed the claim of the assessee."

It is to be stated that a Memorandum of Understanding was also entered into between the family member son on 31st March,2014 with regard to mode of settlement and the payment agreed to be paid to R was directly paid to Banks from whom money was borrowed by R which was outstanding as on 31st March,2014.

After noting down the arguments raised on behalf of both sides, the Tribunal made the following observations at para.8 of its order-

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(i)The business of the partnership firm was a family business. The members of Hindu Undivided Family were the partners. Therefore, when one of the partners was willing to retire from the partnership firm, his share in the capital asset of the firm and profit till retirement would have to be paid to him

.(ii) Under normal circumstances, when the asset of the firm was distributed to the partners on retirement, it would be liable for capital gain tax under section 45 of the Act.

(iii) In this case, there was a family settlement by which all the coparceners agreed to pay a sum of Rs.203.40 lakhs to R and a (further) sum of Rs. 22.60 lakhs to V thus totalling to Rs. 226 lakhs. This family settlement was to protect the family business among the coparceners of the Hindu Undivided Family without any dispute and.

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(iv) It was also not a case of the Revenue that capital gain tax was leviable in this case

After making these observations the Tribunal opined that "there is no transfer of capital asset, hence, it is not taxable for capital gain tax under section 45 of the Act.“

With regard to the question raised by the Revenue regarding the allow ability of expenditure (payment of Rs. 226 lakhs to R and V) the Tribunal answered as follows-

(a) Payment made was only a distribution of asset of the partnership firm on retirement of the partner due to family settlement and.

(b) As the payment was made to keep the business in tact even though it could not be construed as expenditure for business or for royalty,.

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certainly it was a division/distribution of partnership firm's asset by way of paying compensation to R and V and merely because the payment was made to financial institutions and banks at the instructions of R and V, that may not change the character of payment. Thus, the payment to V and R consequent to family settlement, was allowable/deductible while computing the taxable income.

In the result the appeal, filed by the assessee-firm, was allowed by the Chennai Bench of the Tribunal.

6.19 The ITAT Chennai Bench in the case of Shri R. Manogar vs. Asstt. CIT [IT Appeal No. 138 (Mds) of 2010] Assessment Year 2006-07-Date of Order-31st August,2010, following precedents, held that "the family settlement is simpliciter a settlement arrived at to avoid further protracted litigation amongst family members. Under such circumstances, the Courts/Tribunals have excluded the receipt of any capital asset or any consideration out of the purview of section 2(47) of the Act, and it has not been treated as a 'transfer' in the same meaning as it is given in that section."

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One of the decisions cited during hearing and followed by the Tribunal was the one rendered by the Delhi High Court in the case of CIT v. Santokh Singh [2002] 124 Taxman 100/[2001] 252 ITR 707 wherein the assessee under a family arrangement surrendered his rights as co-owner in respect of properties at two places in New Delhi. The assessee contended that the settlement arrived at between the co-owners was bona fide and as such the provisions of section 4(1)(c) of the Gift-tax Act, 1958, were not attracted. The Gift-tax Officer held that section 4(1)(c) of the Gift-tax Act was attracted on the ground that the assessee had surrendered his share in the properties. The Tribunal referred to various clauses of the family settlement and held that the assessee had bona fide abandoned his share in the properties to avoid disputes, differences and misunderstandings which were likely to occur and arise amongst the co-owners for all times to come. It also noted that the properties allotted to co-owners were registered in their names, that no formal deed was considered necessary and held that the settlement was bona fide and genuine.

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The Delhi High Court dismissed the application for reference (in other words did not admit the appeal) by holding that the Tribunal, after referring to the various aspects, held that the family arrangement was bonafide. The conclusion was factual and therefore no question of law arose.

The Delhi High Court also held that "a family arrangement could be arrived at even orally and registration would be required only if it was reduced into writing. Where a document was no more than a memorandum of what had been agreed it did not require registration."

The Delhi High Court also referred to in detail and followed the principles with regard to family settlement enunciated in the 2 well-known decisions of the Supreme Court in the cases of Kale (supra) and Krishna Biharilal (supra).

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Section 4(1)(c) of the Gift-tax Act 1958 read as under-

GIFTS TO INCLUDE CERTAIN TRANSFERS

(1) For the purposes of this Act, --

(c) where there is a release, discharge, surrender, forfeiture or abandonment of any debt, contract or other actionable claim or of any interest in property by any person, the value of the release, discharge, surrender, forfeiture or abandonment, to the extent to which it has not been found to the satisfaction of the Assessing Officer to have been bona fide, shall be deemed to be a gift made by the person responsible for the release, discharge, surrender, forfeiture or abandonment;

Cases wherein genuineness of family settlement vis-à-vis genuineness of transactions was not accepted

7.1 The ITAT Delhi Bench in the case of GaganInfraenergy Ltd. vs. Deputy CIT [2018] 94 taxmann.com 301 (Delhi - Trib.) held that where huge volume of shares in a public limited company was transferred by assessee to another company without any consideration, without any proper documentation being executed as per law and giving it a nomenclature of 'gift', as assessee had not demonstrated by way of documentary evidence genuineness and validity of transaction, matter be remanded

The Tribunal noticed that "There was no proof of any family settlement arrived at when the transferee was a party. Neither there was any family arrangement that had been brought to the notice of the authorities nor had the assessee declared that what had been received by it in lieu of that transfer of shares.

The assessee had failed to establish its relation with G (the done) as well as not executed any gift deed or family settlement, in order to establish the genuineness of the transfer. Merely stating that the transfer was effectuated in lieu of a family realignment was not acceptable without supportive documents in the eyes of law. The assessee had not demonstrated by way of documentary evidence or in any of the manner to prove the genuineness and validity of transaction."

7.2 The Bombay High Court in the case of B.A. Mohota Textiles Traders (P.) Ltd. v. Dy. CIT [2017] 82 taxmann.com 397 held that where assessee-company was under control of members of a family, who were a part of a family settlement, but was a separate legal entity being incorporated as a limited company, transfer of shares by assessee-company amounted to transfer and would be covered within meaning of section 2(47) of the Act so as to be assessable to capital gains tax.

This decision of the Bombay High Court was followed in a subsequent decision in the case of P.P. Mahatmevs.Asstt.CIT[2019] 112 taxmann.com 253 (Bom) wherein the High Court held that sum received on settlement of case of property usurped by relatives was taxable as capital gain. One of the decisions followed in the case of P.P. Mahatme (supra) was the decision rendered by the Punjab and Haryana High Court in the case of Banarsi Lal Aggarwal vs. Commissioner of Gift tax [1998] 96 Taxman 258 (P&H) wherein the facts were that the assessee constructed a property by taking loans from his family members. As he failed to repay the loan, the family members claimed a share in the property. The assessee gave them 3/4th share in a family settlement by way of a Court Decree and claimed that this being, a family settlement, no gift tax (which tax was in existence at that point of time) was chargeable

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The Division Bench of Punjab and Haryana High Court, however, held that merely because the loans were not repaid by the assessee to his family members, it could not create a title in them in the property which would entitle them to claim partition by way of family settlement of the property in question. Based upon such reasoning, the High Court upheld the view taken by the ITAT that there was no valid family settlement amongst the members of the family and based upon such settlement, levy of gift tax could not have been avoided. The High Court considered and distinguished the decision in Kale and others (supra).

The SLP filed against the decision of the Bombay High Court in the case of P.P. Mahatme (supra) has been dismissed by the Supreme Court-refer P.P. Mahatme vs. Asstt. CIT [2021] 126 taxmann.com 176 (SC)

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However, it is to be stated at this stage that the Supreme Court [a Bench consisting of 3 Hon'ble Judges] in the case of Inderjit Singh Sodhi and others vs. The Chairman, Punjab State Electricity Board and another vide its judgment dated 3rd December,2020 in Civil Appeal no. 3837 of 2020 has held that "if a similar SLP has been dismissed by them, it does not create a binding precedent on them. It was also stated that the dismissal of special leave petitions is of no consequence on the question of law**."**

In other words, this decision of the Supreme Court rendered in the case of P.P. Mahatme (supra) was binding only on the assessee vis-à-vis the income-tax department pertaining to that case only as the decision rendered was dismissal of SLP in the following words-

"1. Delay condoned.

2. ***The Special Leave Petitions are dismissed.***

3. Pending applications stand disposed."

7.3 The ITAT Chandigarh Bench in the case of Mrs. Lalitha Rathnam vs.ITO [2013] 35 taxmann.com 371 (Chand - Trib.) held that relinquishment of right over property against receipt of a sum in case of a family settlement falls under definition of 'transfer' and exigible to capital gains tax.

The assessee submitted before the Tribunal that "she got 40 per cent of the said property from her father through gift deed dated 2nd Dec, 2006. She referred to the gift deed and pointed out what was given by her father is in a particular share of the property i.e., 40 per cent share in the overall property. Thus, this property could not have been divided to receive share because her younger brother had received 60 per cent of the share of the said property, through same gift deed. Therefore, the assessee had released her share in favour of her brother through deed dt. 14th Feb., 2007 which should be construed as family settlement and cannot be called a transfer and therefore, money received in the family settlement has to be treated as exempt."

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The Departmental Representative for the Revenue submitted that the Assessing Officer had clearly given a finding that the assessee's brother had given an affidavit through which it has been stated that he had paid a sum of Rs. 30 lakhs as full and final settlement for the said property and it was argued that it was a clear case of transfer of right to property and not case of family settlement and in the case of family settlement, the assessee would have got alternative property or some other right and not simple case.

As the assessee did not have the benefit of the decision of the jurisdictional Punjab & Haryana High Court in the case of Ashwani Chopra (supra) which was rendered on 10th January,2013[though reported earlier] and the Tribunal's order in the case of LalithaRathnam (supra) was passed on 29th August 2012 [though reported later} the assessee could not plan his affairs better which she could have done with the help of "owelty."

7.4 The Delhi High Court in the case of Ashok Soi vs.CIT[2005] 144 Taxman 383 (Delhi), affirming the order of the ITAT Bench in the case of Ashok Soi vs. Deputy CIT [2000] 74 ITD (Del.), held that any amount paid to settle claims of a person having no right, title or interest in property cannot be regarded as expenditure incurred wholly or exclusively in connection with transfer of such property under section 48(i) of the Act.

The assessment year concerned in this case was 1995-96. The assessee was the sole owner of property in question in entirety and he threw the said property in HUF of which he was the Karta. On partition, the assessee, his wife and his two sons were given equal one-fourth undivided share and interest in property and the assessee's father was held to be entitled to receive certain payment out of sale of property for settlement of his claim. Subsequently, a sale deed was executed by the assessee, his wife and their two sons, in favour of the buyer of the property and father of the assessee was a confirming party and capital gain arose to the assessee, his wife and two sons on sale of such property. The assessee claimed deduction under section 48 of the Act in respect of amount claimed to have been paid to his father.

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The High Court based on these facts and agreeing with the order of the Tribunal held though the owners mutually agreed, as indicated in compromise agreement, to pay amounts to assessee's father to settle his claims, it would not mean that by virtue of that assessee's father had got any right in property.

The Tribunal therefore directed that capital gain was required to be computed on the basis of assessee's ownership in such property to extent of his share which was 25 per cent and that any amount paid to settle claims of assessee's father, who had no right, title or interest in that property could not be regarded as 'expenditure incurred wholly or exclusively in connection with such transfer' under section 48(i) of the Act.

7.5 The ITAT Mumbai Bench in the case of ITO vs. Narendra Kapadia [1996] 58 ITD 329 (Mum.) held that **"*Payment to brothers for vacating house, who were allowed to stay in assessee's house out of natural love and affection, cannot be deducted while computing capital gain. Further such payment also does not come within family arrangement.*"**

The Tribunal while allowing the appeal of the Revenue noted at para.4 of its order that there was no material on record to show that the brothers of the assessee had acquired any right in the said flat. The assessee allowed his brothers to stay in the flat out of natural love and affection. No rent was charged. There was no tenancy. There was absolutely nothing on record to show that the amount given to the brothers was in terms of any family settlement. The core of the dispute was not explained. Besides, this house was not the 'family property'. It was the personal property of the assessee. It could not be the subject-matter of the family settlement.

7.6 The facts of the case which arose before the ITAT Ahmedabad Bench in Kusumben Kantilal Shah vs. ITO[1996] 56 ITD 476 (Ahd.) were that shares of companies were held by two groups of shareholders and there was transfer by one group to the other in exchange for certain properties belonging to the company. Though related to each other, the members of the two groups had nothing common as members of family in the matter of title and enjoyment of properties belonging to the company and no family dispute existed in regard thereto.

Based on these facts the Tribunal held as under-

•The transaction in question could not be put within the umbrella of family arrangement and that it was squarely covered by the 'transfer' as contemplated under s. 2(47) of the Act and.

•The assessee having thus transferred her shares on cash payment and received a share in property transferred by company, was liable to capital gains in respect of consideration received including share of value in property after deducting there from original cost of those shares

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The Tribunal speaking through the Learned Accountant Member made the important observation as under-

> "The fact that the Assessing Officer assessing the other two shareholders of the first group had not taxed in their hands the capital gains on the said transfer on the basis of a family arrangement, had no relevance. If another Assessing Officer assessing the other two members of the family did not correctly appreciate the facts of the case, that should not help the assessee whose case had been discussed threadbare by the authorities below. The issue raised here had to be adjudicated de hors any other proceedings to which recourse might have been taken by the revenue. The proceedings under the Income-tax Act and the Gift-tax Act were distinct proceedings and it was the company in whose hand gift tax had been levied and that was not tantamount to double taxation so far as the assessee was concerned."

7.7 The Madhya Pradesh High Court in the case of S.R. Kalani (HUF) vs. CIT [1989] 44 Taxman 269 (M.P), on finding that the family arrangement was not genuine and that the business of the Hindu undivided family continued to belong to it, held that the income from the business was assessable in the hands of the Hindu undivided family.

The assessee-HUF claimed that by virtue of a partial partition between the Karta of HUF and his adoptive mother 'B' certain amount received by 'B' was invested as her share in partnership business set up by converting assessee-HUF's business. This was found to be fictitious by the authorities below the High Court and such a finding was approved by the High Court following its earlier ruling in Kalani (S.R.) (HUF) vs. CIT [1989] 177 ITR 259 (MP)

Other interesting cases

8.1 In the case which arose before the Madhya Pradesh High Court in CIT vs. H.H. Maharani Manekaraje Pawar [1996] 86 Taxman 449 (MP) the facts were as under-

In pursuance of a consent decree to live apart obtained from competent court, the assessee gave some equity shares to his wife along with cash and other properties. The Assessing Officer held that the assessee transferred the shares and other assets and he added the capital gain to the income of the assessee. The assessee filed an appeal claiming that there was no transfer of capital asset and no capital gain assessable under the Act accrued to it. As the claims were rejected by the Commissioner of Income-tax (Appeals), the assessee filed an appeal before the Tribunal. The Tribunal held that there was transfer of shares by the assessee to his wife but no gain accrued which could be added in the income of the assessee as capital gain under section 45 of the Act.

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The Indore Bench of the Tribunal-the order which gave rise to the appeal filed by the Revenue as seen above- categorically observed that “the question of a family settlement comes in when there is a dispute between admitted co-sharers or persons claiming a share in the properties although their rights may be disputed by the other co-sharers. In the present case, the wife was not claiming any right of sharing the assessee’s properties as a co-sharer. Her claim was for maintenance and it was in lieu of maintenance that the properties in question were transferred by the assessee to her. The right of a wife for maintenance is an incident of the status or estate of matrimony and a Hindu is under a legal obligation to maintain his wife. The obligation to maintain the wife is personal in character and arises from the very existence of the relations between two parties. Therefore, when certain property is transferred to the wife in settlement of a claim for maintenance, it cannot, amount to a family settlement because there is no dispute between the co-shares and the other persons are not interested in the dispute.”- refer Maharani Manekaraje Pawar vs. ITO [1986] 15 ITD 545 (Indore)

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The High Court endorsed the views of the Tribunal and held as under-

"The property was given to wife in connection with an agreement to live apart. Such an act is permissible under section 64(1)(iv) of the Act. The giving of property was not as a consideration but was in connection with an agreement to live apart.

According to section 125(4) of the Code of Criminal Procedure, 1898, the wife is disentitled to receive any allowance from her husband if 'they are living separately by mutual consent'.(in this case living apart is through court decree). The assessee in the instant case gave the property in connection with an agreement to live apart and thus created a case of living separately by mutual consent. There was no question of any capital gain in terms of section 45 of the Act. Therefore, the Tribunal was right in law in holding that no capital gain arose to the assessee under section 45 of the Act.

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As to whether, the transaction amounted to transfer, it was found that the assessee extinguished his right on the above said property and as such the act was covered by section 2(47) of the Act and was clearly transfer in terms of the provisions of the Act. The spouse became the owner of the property given to her in connection with the agreement to live apart. It was clearly a case of transfer of capital asset in favour of the wife, though in pursuance of the consent decree and in connection with the agreement to live apart in terms of section 45 of the Act.

Therefore, the Tribunal was right in holding that there was a transfer of shares by the assessee but no capital gain arose to the assessee within the meaning of section 45 of the Act.".

8.2 The Gujarat High Court in the case of CIT vs. Meghjibhai Popatbhai Virani [2013] 35 taxmann.com 100 (Gujarat) held that where the assessee in support of certain amount received from his family members on account of sale of property, produced the family settlement agreement and the sale agreement, there being no defect in the said agreements, the amount so received by assessee could not be added to his taxable income as unexplained money.

The High Court also held that no additions can be made under section 50C of the Act in the hands of the purchaser of the property- which was the - second issue that arose.

The assessment year concerned in this case was 2000-01 but the law at stands today in respect of the second issue is different.

Section 56(2)(x) of the Act as on date-which will take care of this difference- reads as under-

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(2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes shall be chargeable to income-tax under the head “Income from other sources”, namely: —

(x) where any person receives, in any previous year, from any person or persons on or after the 1st day of April, 2017,

(a) any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum;

(b) any immovable property, —

(A) without consideration, the stamp duty value of which exceeds fifty thousand rupees, the stamp duty value of such property;

(B) for a consideration, the stamp duty value of such property as exceeds such consideration, if the amount of such excess is more than the higher of the following amounts, namely: —

(i) the amount of fifty thousand rupees; and

(ii) the amount equal to ten per cent. of the consideration:

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Provided that where the date of agreement fixing the amount of consideration for the transfer of immovable property and the date of registration are not the same, the stamp duty value on the date of agreement may be taken for the purposes of this sub-clause:

Provided further that the provisions of the first proviso shall apply only in a case where the amount of consideration referred to therein, or a part thereof, has been paid by way of an account payee cheque or an account payee bank draft or by use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed, on or before the date of agreement for transfer of such immovable property:

SUPREME COURT HOLDS THAT TERMS OF FAMILY SETTLEMENT HAVE TO BE RESPECTED AND FOLLOWED- GENERAL LAW

9.The Supreme Court in the case of Hansa Industries Pvt. Ltd. and Ors. vs. Kidarsons Industries Pvt. Ltd.-Civil Appeal Nos. 1682 and 1705 of 1999- Date of Judgment -13th October,2006- LIS/SC/2006/818- [2006] 8 SCC 531 held that "It is trite that the terms of family settlement reached between the parties shall ordinarily not be modified except with the consent of the parties."

The Supreme Court noted at para.7 of its judgment that "The High Court in its impugned judgment has observed that having regard to the acrimony between the parties it was practically impossible for them to live in the same house. The strained relationship between the parties was evident from the fact that there had been instances of violence, and matters reached such a stage that reports were made to the police.

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The High Court also observed that being leasehold property, sub-division of the property was not permitted. It further observed that under the settlement, the appellants were entitled to 30.14% of the assets of the Company and only a sum not exceeding 5 lakhs could have been paid by the Company in cash, if the same was found necessary, and vice- versa. Having regard to these circumstances the Learned Judges held that the interpretation placed on Clause 14 by the Learned Single was correct and the said property could not in any manner be given to N, one of the parties to the dispute."

The Supreme Court then referred to the decision of the Supreme Court in the case of Kale (supra) regarding the essentials of the family settlement and the principles governing the existence of the same.

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The Supreme Court made the pertinent observations at para.13 of its judgment

> "It is true that the High Court has taken note of the practicalities of the situation and has proceeded on the basis that the appellants and the respondents cannot peacefully live in the same premises. The High Court has, therefore, not favoured allotment of a portion of the house in favour of appellant No.2 and has approved the allotment of the house to the respondents who owned the majority shares in the respondent No.1 Company. This was done with a view to ensure that the parties live separately but in peace and harmony. We cannot find fault with the concern shown by the High Court, but the problem which arises in the instant case is that the High Court was not considering a matter in which it could have exercised its discretion to make allotment one way or the other as in a case of family partition. The decree of the Court is based upon a settlement reached between the parties.

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Even at the time when the settlement was reached the parties were well aware of the strained relationship which existed and the unfortunate events that occurred between the branch of appellant No.2 and the remaining members of the family. Despite this, it was agreed by all of them that the portion in occupation of appellant No.2 shall be allotted to him and the value thereof adjusted against his share. The respondents cannot now be heard to say that it would be inconvenient for them to reside with appellant No.2 and his family members in the same house, though in separate portions. The question as to how the parties will manage their affairs is a matter with which they only are primarily concerned and the Court cannot advise them in the matter. It may be that the architects may provide a solution for their problems, or it may be that in view of the circumstances one party may agree to sell its share or buy the share of the other party with a view to purchase peace, if that becomes necessary. These are matters in which the Court may have nothing to say."

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The Supreme Court decided the issue in favour of the appellants after observing at para.14 as under-

"Clause 14 of the settlement being unambiguous, clear and categoric, it must be given effect because one cannot term the said Clause 14 as vitiated by fraud, or illegal being in breach of any statutory provision, or against public policy, or hit by the principle of impossibility of performance. The settlement was made bona fide by the parties to resolve all their disputes and all facts were known to the parties when they reached the settlement. With their eyes open and fully aware of their experiences of the past, they agreed to share the Golf Links property. The relevant clause in the settlement is not vitiated by any consideration which may impel the court not to give effect to that clause in the settlement. The question of practical inconvenience should have concerned the respondents when they entered into the settlement. They cannot at the stage of implementation of the settlement avoid a covenant in the settlement solemnly incorporated with their consent on the pretext of practical inconvenience of living in the same house, albeit in separate portions, in the unfortunate background of bickerings and acrimony. This issue must, therefore, be decided in favour of the appellants."

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From the decision of the Supreme Court, it is therefore clear that unless the family settlement deed is framed by fraud, or illegal being in breach of any statutory provision, or against public policy it has to be respected by adhering to all the terms of the family settlement in letter and spirit. Of course, the terms of settlement reached between the parties can be modified with the consent of the parties to the family settlement.

SUPREME COURT REITERATES MEMORANDUM OF UNDERSTANDING DOES NOT REQUIRE REGISTRATION

10. In the case decided by the Supreme Court in the case of Ravinder Kaur Grewal &Ors.vs. Manjit Kaur &Ors.-Civil Appeal No.7764/2014-Decision dated 31st July,2020 the question of law involved was as to whether the Memorandum of Family Settlement was required to be registered as interest in immovable property worth more than Rs.100/- was transferred thereby?

The facts of the were that certain disputes arose questioning the ownership after a family settlement was arrived between closely related parties under the supervision of respectable persons and family members, whereunder ownership and possession in respect of the land including constructions thereon was decided, accepted and acknowledged in favour of the appellant R (herein before the Supreme Court).

Though the issue was decided in favour of the appellant R by the first appellate Court the High Court decided the issue in favour of the respondent M (herein before the Supreme Court).

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The Supreme Court made the following observations at para.16 of its judgment-

(i)The family settlement had been clearly established that there was not only univocal family arrangement between the parties, but it was even acted upon by them without any exception.

(ii)The settled legal position is that when by virtue of a family settlement or arrangement, members of a family descending from a common ancestor or a near relation seek to sink their differences and disputes, settle and resolve their conflicting claims or disputed titles once and for all in order to buy peace of mind and bring about complete harmony and goodwill in the family, such arrangement ought to be governed by a special equity peculiar to them and would be enforced if honestly made and

(iii)The object of such arrangement is to protect the family from long drawn litigation or perpetual strives which mar the unity and solidarity of the family and create hatred and bad blood between the various members of the family, as observed in Kale (supra)

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The Supreme Court allowed the appeal of R by making the following observations at para.19 of its judgment-

> "We have no hesitation in concluding that the High Court committed manifest error in interfering with and in particular reversing the well-considered decision of the first appellate Court, which had justly concluded that document dated 10.3.1988 executed between the parties was merely a memorandum of settlement, and ***it did not require registration."***

SUPREME COURT HOLDS THAT "COMPROMISE DECREE" DOES NOT REQUIRE REGISTRATION

11.The Supreme Court in the case of Mohammade Yusuf & others vs. Rajkumar & others in Civil Appeal No.800 of 2020- Date of Judgment-5th February,2020 held as under-

> "When registration of an instrument as required by Section 17(1)(b) of the Registration Act,1908 is specifically excluded by Section 17(2)(vi) of the Registration Act,1908 by providing that nothing in clause (b) and (c) of sub-section (1) applies to any decree or order of the Court, we are of the view that the compromise decree dated 04.10.1985 did not require registration and learned Civil Judge as well as the High Court erred in holding otherwise. We, thus, set aside the order of the Civil Judge dated 07.01.2015 as well as the judgment of the High Court dated 13.02.2017. The compromise decree dated 04.10.1985 is directed to be exhibited by the trial court. The appeal is allowed accordingly."

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Section 17(1) of the Registration Act,1908 deals with documents of which registration is compulsory. Section 17(2) of the Registration Act,1908 provides that nothing in clauses (b) and (c) of sub-Section (1) applies to various documents as enumerated therein.

The Supreme Court referred to its earlier decision in the case of Som Dev and Others vs. Rati Ram and Another, [2006] 10 SCC 788 for arriving at such a conclusion i.e., in favour of the appellant at para.13 of its decision-.

> '13. This Court in Som Dev and Others (supra) while explaining Section 17(2)(vi) and Section 17(1)(b) and (c) of the Registration Act,1908 held that all decree and orders of the Court including compromise decree subject to the exception as referred that the properties that are outside the subject matter of the suit do not require registration. In paragraph 18 this Court laid down the following-

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"18. ……But with respect, it must be pointed out that a decree or order of a court does not require registration if it is not based on a compromise on the ground that clauses (b) and(c) of Section 17 of the Registration Act are attracted. Even a decree on a compromise does not require registration if it does not take in property that is not the subject-matter of the suit……."

Concluding Remarks

12.From this detailed presentation it is understood in no uncertain terms that the Family Settlement/Arrangement has to be real.

Where there is no genuine family settlement, such an attempt is bound to misfire as happened in the case decided by the Gauhati High Court in the case of. CIT vs. vs. Mrs. Bibijan Begum [1997] 90 Taxman 362 (Gau).

The facts which arose before the Gauhati High Court in this case were that the assessee, a Mohammedan lady, filed her income-tax return offering one-fifth share of income from house property in her return claiming to have only one-fifth ownership in the land and building by virtue of a family settlement/agreement dt. 9th June, 1976. The assessee had earlier received the land by way of "mehar."

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The Assessing Officer, on noticing that permission to construct the building on the land was given by the Municipal Corporation to the assessee exclusively and the bank loan was also taken by the assessee herself on the security of the said land assessed the entire rental income in the hands of the assessee. The Tribunal,however, held in favour of the assessee-refer Mrs. Bibijan Begum vs. ITO [1990] 32 ITD 157 (Gau).

The High Court, on appeal by the Revenue, held that the Assessing Officer was justified in assessing the entire income from house property in the hands of the assessee "as concept of family arrangement is not very common among the Mohammedans and that further, there being no existing family dispute, the assessee, the sole owner of the property, could not make any family arrangement with her sons and daughters who were governed by Mohammedan law and that the Tribunal was not justified in holding that there was a valid family arrangement and income from the property could be assessed in the hands of all the persons concerned."

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In the decision in the case of Banarsi Lal Aggarwal (supra) which was covered in the earlier part of this article, the Tribunal was not swayed away by a family settlement obtained through court decree and it was found by the Tribunal, that the fact that there was a court decree, did not mean that there was a genuine family arrangement, because it was found that the claim that the family members had advanced loans was not real. This view of the Tribunal, as stated in the earlier part of the article was affirmed by the Punjab & Haryana High Court.

It had been found that in similar circumstances where an untenable arrangement was made between the parties, capital gains tax or the then gift-tax could not be avoided, where beneficial enjoyment in reality stood transferred as in CIT vs. Bharani Pictures [1980] 3 Taxman 478 (Mad).

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In CGT vs. S. N. Zaman and S. M. Elahi [1997] 91 Taxman 177 (Gauhati)), as a result of disputes between the members of the family a firm was dissolved and other properties were subject-matter of a family arrangement. Since the father had given up his right in some property as part of a settlement by way of family arrangement, the Assessing Officer presumed a gift to the extent to which he assumed that the father had given up his share in the property. The High Court found that there was a valid family arrangement. In coming to the conclusion, it distinguished its own earlier decision in Mrs. Bibi Jan Begum's case (supra) and held that there was no liability to gift-tax in a bona fide family arrangement.

These two Gauhati High Court decisions clearly throw further light on the concept indicating that the existence of a present or potential genuine dispute is a precondition of a bona fide family arrangement.

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It is apt to conclude this presentation by extracting the following passage from the celebrated decision in the case of Kale (supra)

"9…… A family arrangement by which the property is equitably divided between the various contenders so as to achieve an equal distribution of wealth instead of concentrating the same in the hands of a few is undoubtedly a milestone in the administration of social justice. That is why the term "family" has to be understood in a wider sense so as to include within its fold not only close relations or legal heirs but even those persons who may have some sort of antecedent title, a semblance of a claim or even if they have a spessuccessionis so that future disputes are sealed for ever and the family instead of fighting claims inter se and wasting time, money and energy on such fruitless or futile litigation is able to devote its attention to more constructive work in the larger interest of the country. **The courts have, therefore, leaned in favour of upholding a family arrangement instead of disturbing the same on technical or trivial grounds. Where the courts find that the family arrangement suffers from a legal lacuna or a formal defect the rule of estoppel is pressed into service and is applied to shut out plea of the person who being a party to family arrangement seeks to unsettle a settled dispute and claims to revoke the family arrangement under which he has himself enjoyed some material benefits.** ….."

Though various issues with regard to family settlement/arrangement have been discussed in a detailed manner what has been covered is only “a tip of the iceberg” on this vast but a very interesting topic.

One must appreciate, from this detailed discussion that the concept of “family settlement” is only judge-made concept and a judge makes a decision, “not according to his own judgment, but according to the known laws and customs of the land; not delegated to pronounce a new law, but to maintain and expound the old one.”

It should also be appreciated that a judge made law, also known as stare decisis or case law, is the legal rule, ideal, or standard that is based on the past decisions of other judges in past cases, instead of laws made by an elected, legislative body.

It is very humbly submitted that study of this interesting topic requires lot of focussed time and concentrated reading coupled with detailed analysis of various useful materials available on this subject.

Adapted from my article published on Taxmann Website


Thank You

Other Important point for discussion

1. CIT vs. SEA ROCK INVESTMENT LTD [2009]317 ITR 253 (KAR)

P Group Company

↓ Shareholders

Family Members of P Group – Shareholders of Company

↓ Dispute between Family Members and referred for Arbitration

Shares of the Company transferred to family members

↓

Assessee claimed – ARBITRATION AWARD - Family Arrangement – Hence no tax

↓

ITAT held in favour of Assessee

↓

High Court ⟶ Assessee, a different legal entity liable to pay capital gain tax as the share holders as members of the joint family had no right to exercise power on the asset of the company

↓

But set aside the ITAT order to consider whether any consideration had passed as argued by the assessee that no consideration passed, hence no capital gain tax

2.B.A. Mohata Textiles Traders (P) Ltd Vs Deputy Cit [2017] 82 Taxmann.Com 397 (Bombay)

A Private Ltd. Company (P)

↓ 80%+Share Capital

A Group, B Group, C Group → One Family

↓

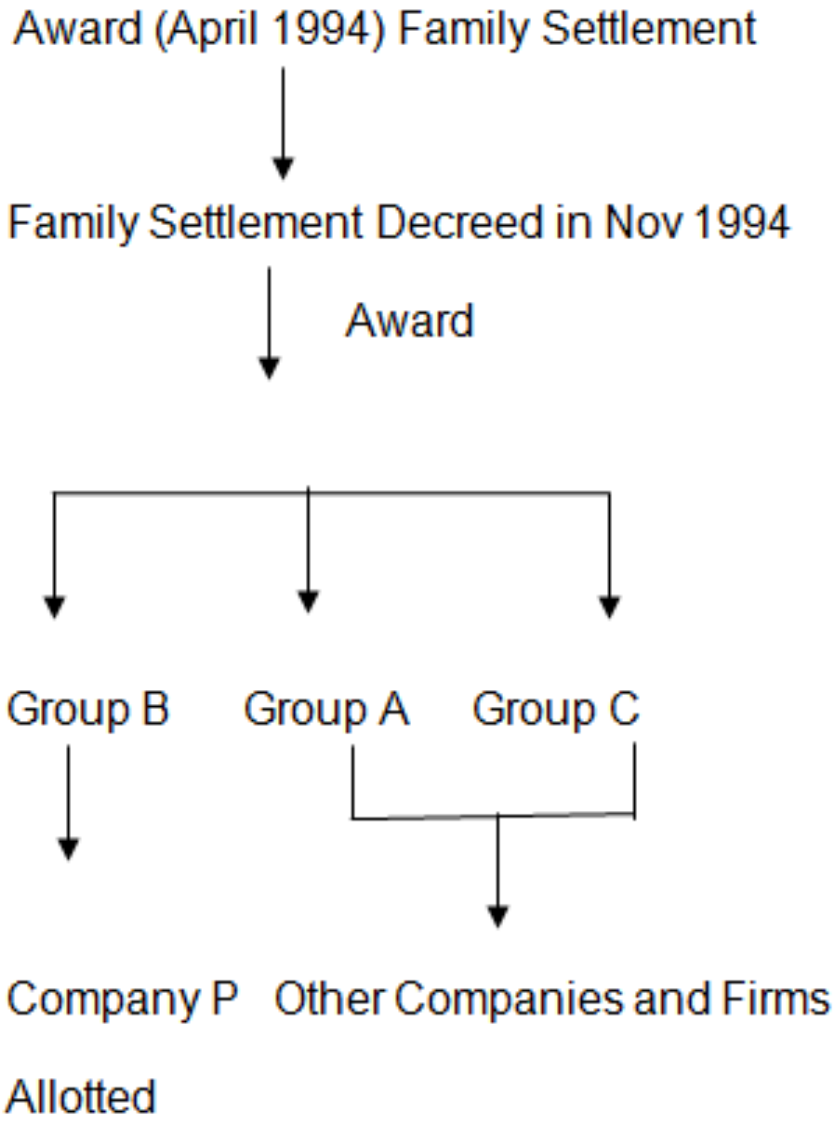
(Also had joint Interest in other Companies and Partnership Firms)

↓ Disputes

Arbitrator

↓

Award (April 1994) Family Settlement


Award (April 1994) Family Settlement
Family Settlement Decreed in Nov 1994
Award
Group B
Group A
Group C
Company P
Other Companies and Firms
Allotted

Award

↓

Shares in Various Companies had to be rearranged and were valued for this purpose

↓

Assessment

↓

Assessee → No Capital gain as a result of family arrangement

A.O. → Capital gain tax Leviable

[Company being a separate legal entity, it cannot be a part of family settlement]

CIT-A → Transfer of shares amounted to transfer u/s 2 (47) of the act

ITAT → Concurred with these view

HC → Family arrangement would bind only the members of the family but not the company.

- The Bombay High Court , thus, took a view different from that of the Madras High Court in the case of Kay Arr Enterprises (supra) (which decision was neither referred to nor considered by the Bombay High Court) wherein the Madras High Court held that " re-arrangement of shareholdings in company to avoid possible litigation among family members is a prudent arrangement necessary to control company effectively by major shareholders to produce better prospects and active supervision and in case of such rearrangement of shareholding, it cannot be held that there is transfer of shares liable to capital gains tax.

In the case of family arrangement/settlement the total value of properties- both movable and immovable -is estimated and division of the properties is then made in the manner agreed upon between the family members to the dispute.

- When rearrangement of shares in immovable properties is made no registration is required to be done. It is well-settled that registration would be necessary only if the terms of the family arrangement are reduced into writing. Here also a distinction should be made between a document containing the terms and recitals of a family arrangement made under the document and a mere Memorandum prepared after the family arrangement had already been made either for the purpose of the record or for information of the Court for making necessary mutation. In such a case the Memorandum itself does not create or extinguish any rights in the immovable properties and, therefore, does not fall within the mischief of section 17(1)(b) of the Registration Act and is, therefore, not compulsorily registrable. So, there will be no metes and bounds of division of immovable properties and the properties with proportionate holding are identified through door numbers and/or survey numbers. In other words, the family members will be holding the property as tenants-in-common in contrast to joint tenants.

1. Each State has its own laws and if registration is done it would consequently involve cost. In the case of movables such as fixed deposits the names are changed by mutation of records. But if there is rearrangement of shareholding in a company it is done by transfer of shares from one person/group to another person/group by reducing /increasing percentage of holding, as the case may be.

The methodology stated above would fall within the parameters of family arrangement/settlement and, as such, family arrangement/settlement would not amount to transfer, it would be outside the purview of capital gains taxation. The same would be the situation even in rearrangement of shareholding between different persons/groups in different companies, as there can never be transfer of money in such cases.

How can the transferor-company account for such money received in its books of account in respect of transfer of shares vis-à-vis the shareholders who have been allotted shares in the transferor-company? It is submitted with great respect that the Bombay High Court, without appreciating the facts obtaining in the case and accounting concept/principles that there was no receipt or transfer of consideration by the assessee in physical form either through bank or electronic transfer, has held against the assessee.

The arguments put forth on behalf of the assessee and the conclusion arrived by the High Court may be found at Para. 12 of the judgment which runs as under: –

> "12. It was also submitted that no consideration was received by the Appellant/assessee for the transfer of shares.

- It is submitted that the fair market value of M/s. R.S. Rekhchand Mohota Spinning and Weaving Mills Ltd. arrived at Rs. 225 per share and that of M/s. Vaibhav Textiles Pvt. Ltd. arrived at Rs. 10 per share by the Arbitrator was only for the purposes of adjustment of rights amongst the parties. This submission overlooks the fact that the Arbitration Order annexed to the decree (Page 62 of the Appeal memo) itself records that the shares in M/s. R.S. Rekhchand Mohota Spinning and Weaving Mills Ltd. and M/s. Vaibhav Textiles Pvt. Ltd. are to be transferred at a consideration of Rs. 225 and Rs. 10 per share respectively. Thus, the consideration has been determined and accepted by the members of the family, who are in management of the Assessee/Company."

- While drafting a Memorandum of family arrangement/settlement, values are assigned to various movable and immovable properties forming part of such arrangement and this procedure has only been adopted by the Arbitrator in this case by assigning values to shares transferred and as rightly argued on behalf of the assessee that there was no transfer of consideration through physical or transfer mode. It is definitely not out of place to submit that the assessee-company, though a separate legal entity yet was part and parcel of the memorandum of family arrangement/settlement entered into between the families to resolve the dispute and value of its shares was also a factor in determining the share of each group. Why were not the records of the assessee-company produced to prove that there was no physical transfer of consideration? It is submitted, with respect, that the High Court could have remanded the matter to the Tribunal as happened in the case of Sea Rock Investment Ltd. (supra) decided by the Karnataka High Court to ascertain whether any consideration passed on such transfer of shares.

It is to be stated that the decision of the Karnataka High Court in the case of Sea Rock Investment Ltd. (supra) was not referred to, before the Bombay High Court in the instant case.

The concept of separate legal entity for the company coupled with wrong assumption of receipt of consideration by the assessee-company by the High Court seems to have swayed the pendulum in favour of Revenue. The additional argument (which was totally not warranted) put forth on behalf of the assessee with regard to lifting of corporate veil in favour of the assessee-company also worked against the company and titled the scale against it

It is therefore submitted with respect that the conclusion of the High Court that "the Tribunal was correct in holding that the transaction of transfer of shares by the independent corporate entity was assessable to capital gain tax" is wrong and requires reconsideration by a full bench