

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

% Reserved on : September 12, 2007
Date of Decision : October 5, 2007

+ **ITR No. 271 of 1984**

COMMISSIONER OF INCOME TAX Appellant.
Through Ms. P.L.Bansal, Advocate.

versus

M/S. NARINDER MOHAN FOUNDATION Respondent
Through Mr. P.N.Monga with Mr. Manu Monga,
Advocates.

AND

+ **ITR No. 381 of 1984**

COMMISSIONER OF INCOME TAX Appellant.
Through Ms. P.L.Bansal, Advocate.

versus

M/S. NARINDER MOHAN FOUNDATION Respondent
Through Mr. P.N.Monga with Mr. Manu Monga,
Advocates.

CORAM:

HON'BLE MR. JUSTICE MADAN B. LOKUR

HON'BLE DR. JUSTICE S. MURALIDHAR

1. Whether Reporters of local papers may be allowed to see the order? Yes
2. To be referred to the reporter or not? Yes
3. Whether the order should be reported in the Digest? Yes

DR. S. MURALIDHAR, J.

1. These two cases are references made to this Court by the Income Tax Appellate Tribunal ('Tribunal') Delhi Bench "E", New Delhi under Section 256 (1) of the Income Tax Act 1961 ('Act'). The questions referred for two Assessment Years are more or less similar. Relevant to the Assessment Year 1976-77, the following questions of law have been referred for our opinion

in ITA No. 2601/Del/1979:

1. Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that 5,06,076 shares being bonus shares of M/s. Mohan Meakin Breweries Ltd ('MMBL'). Received by the assessee did not represent funds of the trust invested in the said concern for purposes of section 13(4) of the Act?
2. Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the prohibited category of persons mentioned in Section 13(3) did not have substantial interest in MMBL in which the funds of the assessee were invested and, therefore, the provisions of section 13(2)(h) were not applicable?
3. Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the trust was entitled to exemption as stipulated under Sections 11 and 12 of the Act?

2. Relevant to the Assessment Year 1977-78, the following questions of law have been referred for our opinion in ITA No. 2305/Del/1982:

1. Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that 8,86,076 shares being bonus shares of MMBL received by the assessee did not represent funds of the trust invested in the said concern for purposes of sec. 13(4) of the Act?
2. Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the prohibited category of persons mentioned in section 13(3) did not have substantial interest in MMBL in which the funds of the assessee were invested and, therefore, the provisions of section 13(2)(h) were not applicable?"

3. The Assessee Trust, Narinder Mohan Foundation, was founded by late N.N.Mohan, Managing Director of MMBL and a Trust Deed dated 25.3.1964 was executed by him for the purpose and got registered. The Trust property initially consisted of Rs. 10,000 transferred by N.N.Mohan

from his account in Punjab National Bank. Subsequently the Trust received substantial donations in cash and by way of shares and securities. The Trust purchased 1,08,082 shares of MMBL. In addition the trust received a donation of 5,11,261 shares and 5,06,076 bonus shares of MMBL.

4. In its income tax return filed for the Assessment Year 1975-76 the Assessee Trust, inter alia, disclosed that the income from dividend was in the sum of Rs.6,75,251. During scrutiny by the Income Tax Officer (hereafter 'ITO') a question arose whether in terms of Section 13(1)(h) of the Act the income of the trust had remained invested in any concern in which any person referred to under Section 13(3) has a substantial interest. After considering the replies of the Assessee Trust, the ITO found that the 11,25,418 shares held by the Assessee Trust in MMBL, including the bonus shares and shares received by way of donation, were more than 5% of the total share holding of MMBL and therefore the benefit of Section 13 (4) of the Act was not available. As regards the pattern of the share holding in MMBL, the following shares held by a certain category of persons came for scrutiny:

<u>Shares Held by</u>		<u>No. of Shares</u>
i)	Six HUFs	7,30,849
ii)	Five Trusts settled by members of the Mohan family for benefit of unborn persons and Future spouses	3,00,000
iii) a)	Bakshi Sampuran Singh	64,485
b)	Balbair Singh	29,915
c)	Ranbir Singh	29,915
d)	Kulbir Singh	29,215
		1,53,530

5. The Revenue contended that if the above shares were added to the shares held in MMBL by the Assessee Trust then the holding of the 'prohibited' category of persons in terms of Section 13 (2) (h) read with Section 13 (3) would exceed 20% of the total paid up share holding of MMBL. This would make the income ineligible for exemption in terms of Sections 11 and 12 of the Act. This view was accepted by the AO.

6. The appeal filed by the Assessee Trust was allowed by the Commissioner of Income Tax (Appeals) ['CIT(A)']. It was held by the CIT (A) that the bonus shares and shares received by way of donation had to be excluded for computing the percentage of shareholding of the Assessee trust in MMBL. Consequently the CIT (A) held that the Assessee Trust was entitled to the benefit of Section 13 (4) of the Act. As regards the shares held by the 'prohibited category' of persons and close relatives, the CIT (A) accepted the contention of the Assessee Trust that this did not exceed 20% of the total shareholding in MMBL and that therefore the Assessee trust was entitled to exemption in terms of Sections 11 and 12 of the Act.

7. In the further appeal by the Revenue, the Tribunal concurred with the CIT (A) that for the purposes of Section 13 (4), the bonus shares and shares received by way of donation had to be excluded. It also concurred with the CIT (A) that for the purposes of Section 13(2)(h) the 7,30,849 shares held by the six HUFs and the 3,00,000 shares held by the five trusts had to be excluded. Therefore the total number of shares held by the persons answering the description of those listed in Section 13 (3) was 15,80,477

which was about 18.5% of the total shares in MMBL. The Tribunal concluded that the prohibited categories of persons mentioned in Section 13(3) did not have a substantial interest in MMBL (in which the funds of the Assessee Trust were invested) and therefore the provisions of Section 13(2)(h) were not applicable. As regards Assessment Year 1977-78, the Tribunal followed its order for the Assessment Year 1976-77 and dismissed the appeal of the Revenue.

8. As regards question (1) in the reference for both the Assessment Years 1976-77 and 1977-78, it is not in dispute that in view of the decisions of this Court in *Commissioner of Income Tax v. Sir Shri Ram Foundation (2001) 250 ITR 55* and *Commissioner of Income-Tax v. Sir Sobha Singh Public Charitable Trust (2001) 250 ITR 475*, wherein it has been held that the bonus shares received by a trust cannot be said to be funds invested by the trust for the purposes of Section 13(4) of the Act, the question requires to be answered in the affirmative, that is, against the Revenue and in favour of the Assessee.

9. The second and third questions referred for the Assessment Year 1976-77 and the second question referred for Assessment Year 1977-78 are similar with only the actual figures of the number of shares and the amount of dividend being different. Both sets of questions require an examination whether the prohibited category of persons mentioned in Section 13(3) of the Act do not have substantial interest in MMBL in which the funds of the Assessee were invested. If the prohibited category of persons did have a substantial interest in MMBL, then the provision of Section 13(2)(h) would

stand attracted. The relevant provisions of the Act read as under:

“13. (1) Nothing contained in section 11 or section 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof-

(a) to (bb) xxxxxxxx

(c) in the case of a trust for charitable or religious purposes or a charitable or religious institution, any income thereof-

(i) if such trust or institution has been created or established after the commencement of this Act and under the terms of the trust or the rules governing the institution, any part of such income enures, or

(ii) xxxxx

directly or indirectly for the benefit of any person referred to in sub-section (3)

(2) Without prejudice to the generality of the provisions of clause (c) and clause(d) of sub-section (1), the income or the property of the trust or institution or any part of such income or property shall, for the purposes of that clause, be deemed to have been used or applied for the benefit of a person referred to in sub-section (3),-

(a) to (g) xxxxxxxx

(h) if any funds of the trust or institution are, or continue to remain, invested for any period during the previous year (not being a period before the 1st day of January, 1971), in any concern in which any person referred to in sub-section (3) has a substantial interest.”

(3) The person referred to in clause (c) of sub-section (1) and sub-section (2) are the following, namely:-

(a) the author of the trust or the founder of the institution;

(b) any person who has made a substantial contribution to the trust or institution, that is to say, any person whose total contribution up to the end of the relevant previous year exceeds fifty thousand rupees;

(c) where such author, founder or person is a Hindu undivided family, a member of the family;

(cc) any trustee of the trust or manager (by whatever name called) of the institution;

(d) any relative of any such author, founder, person, member, trustee or manager as aforesaid;

(e) any concern in which any of the persons referred to in clauses (a), (b), (c) [(cc)] and (d) has a substantial interest.

(4) to (7) xxxxxxxx

Explanation 1.- For the purposes of sections 11,12,12A and this section, “trust” includes any other legal obligation and for the

purposes of this section “relative”, in relation to an individual, means-

- (i) spouse of the individual;
- (ii) brother or sister of the individual;
- (iii) brother or sister of the spouse of the individual;
- (iv) any lineal ascendant or descendant of the individual;
- (v) any lineal ascendant or descendant of the spouse of the individual;
- (vi) spouse of a person referred to in sub-clause (ii), sub-clause (iii), sub-clause (iv) or sub-clause(v);
- (vii) any lineal descendant of a brother or sister of either the individual or of the spouse of the individual.

Explanation 2. xxxxxx

Explanation 3.- For the purposes of this section, a person shall be deemed to have a substantial interest in a concern,-

- (i) in a case where the concern is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than twenty per cent of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of the other persons referred to in sub-section (3);
- (ii) in the case of any other concern, if such person is entitled, or such person and one or more of the other persons referred to in sub-section (3) are entitled in the aggregate, at any time during the previous year, to not less than twenty per cent of the profits of such concern.”

10. The scheme of the above provisions of the Act relevant for the present purposes is that the income of a Trust is generally exempt from taxation when such Trust is for charitable or religious purposes. Section 12 specifies the types of income that would be deemed to be the income derived from the property held by the Trust wholly for charitable and religious purposes. Section 13 sets out the conditions under which income earned by the Trust would not qualify for exemption under Sections 11 or 12. If the income of the Trust during the previous year is applied directly or indirectly for the benefit of a person referred to in sub-section (3) then the

income would not be so exempt. For this purpose Section 13(2) sets out the kinds of income which would be deemed to have been used or applied for the benefit of a person referred to in sub-section (3). Under Section 13(2)(h) one such deemed income would be an investment by the Trust in any concern in which the person referred to in sub-section (3) has a substantial interest. Explanation 3 is a deeming provision as regards substantial interest. Explanation 3 (ii) states that a person shall be deemed to have substantial interest if such person and one or more persons referred to in sub-section (3) of Section 13 are “entitled in the aggregate” “to not less than 20% of the profits of such concern” which in this case is MMBL. In other words, a shareholding in excess of twenty percent of the paid-up share capital would in terms of Explanation 3 connote substantial interest.

11. As far as the Assessee Trust is concerned if the dividend earned by it in the shares of MMBL in which it has invested its funds is to be brought to tax in terms of Section 13(2)(h) it would have to be shown that persons referred to in sub-section (3) have a substantial interest in MMBL. The categories of persons mentioned in this provision include the author of a Trust or the founder of the institution, any person whose contribution to the Trust exceeds Rs.50,000, where the author is a Hindu Undivided Family ('HUF') a member of the family, any trustee of the Trust or manager. Any relative of any such author, founder person or even trustee are all mentioned in said Section 3. Explanation 1 further describes a relative to include spouse in the individual, brother or sister of the spouse of the individual, any lineal ascendant or descendant of the individual or any spouse of a

person referred to in sub-clause (ii), sub-clause (iii) etc.

12. The share holding pattern of MMBL therefore becomes relevant. It is not in dispute that for the Assessment Year 1976-77, six HUFs having the members of the Mohan Family as kartas held 7,30,849 shares in MMBL. The CIT (A) and the Tribunal have concurrently found that they do not fall within the prohibited categories of persons referred to in Section 13(3) read with Explanation 1. After considering the submissions of learned counsel for the parties, we are not inclined to take a different view. It is not possible to read Section 13 (3) as bringing within the fold of prohibited persons an HUF, which is a taxable entity by itself. The device of piercing the veil of the legal entity of a HUF in order to ascertain the person in actual control of its functioning is unknown to this branch of tax law. The submission of Ms. Bansal that the persons who are actually in charge of the HUFs are themselves mentioned individually in Section 13(3), and therefore it is implied that the HUF itself is one of the prohibited categories cannot be accepted. Taxation statutes admit of a strict interpretation. It is not possible to write into the categories mentioned in Section 13 (3) a category that is not mentioned there. For this reason we are not inclined to interfere with the conclusion reached by the Tribunal that the shares of the HUF cannot be considered for the purposes of determining whether the persons mentioned in Section 13(3) have a substantial interest in MMBL.

13. The next lot of shares which require to be considered is 3 lakhs shares held by the various trusts. Ms. Prem Lata Bansal places reliance upon the

judgment of this Court in *Commissioner of Income-Tax v. Brigadier Kapil Mohan (2001) 252 ITR 830* to contend that even if the beneficiaries of the Trusts which hold shares in MMBL were unknown, it cannot be said that the Trusts did not hold the shares beneficially for any person. On the other hand Mr. Monga, learned counsel for the Assessee submits that the categories mentioned under Section 13(3) does not include a Trust in itself and, therefore, it would be stretching the language of the Section impermissibly to bring the share holding of the Trust within the mischief of Section 13(2)(h) read with Section 13(3) of the Act.

14. The Tribunal itself has observed in para 18 of its order dated 21st October, 1989 that a Trust cannot be a legal owner of the shares in terms of Section 153 of the Companies Act, 1956. It is the trustees who are the legal owners who hold the shares beneficially for certain persons specified in the trust deeds. The Tribunal has also observed that copies of three trust deeds have been furnished to it. Two of them were dated 22nd May, 1973 executed by Mrs. Comilla Mohan for the benefit of the first son of Shri Hemant Mohan. The second deed dated 22nd May, 1973 was executed by Mr. Rakesh Mohan for the benefit of the first son of Shri Pankaj Mohan. A third deed dated 18th July, 1973 was executed by Mrs. Comilla Mohan for the benefit of the first son of Shri Vinay Mohan. The Tribunal also proceeded on the footing that the trustees of the five Trusts were persons covered under Section 13(3) of the Act. Therefore the only question that remained was whether these trustees were holding the shares for the beneficiaries. The Tribunal then proceeded to answer this question by

holding that the beneficiaries were known and therefore it cannot be said that the trustees were holding the shares beneficially for them.

15. At the time the Tribunal gave its judgment it did not have the benefit of the judgment of this Court dated 16th May, 2001 in the case of ***Brigadier Kapil Mohan***. There too a contention had been raised that the beneficiary of the Trust was unknown and, therefore, it cannot be said that the shares would be held beneficially by the trustees. It was argued that since the children for whose benefit the shares were held had not yet been born, the provision of Section 13(3) would not get attracted. This Court negated this argument and pointed out as under:

“In order to constitute a valid trust the author of the trust must indicate with reasonable certainty:(a) the intention on his part to create a trust, (b) the purpose of the trust, (c) the beneficiaries, (d) the trust property, and (e) transfer of property to the trust. According to learned counsel for the Revenue except condition (c) all other conditions are present here. We find that it is not a case where the beneficiary was unknown or indefinite. In fact it was clearly stipulated that the beneficiary was the first son of Shri Rakesh Mohan.”

“A transfer cannot be made directly to an unborn person, for the definition of transfer in section 5 is limited to living persons. Such transfer can only be made by the machinery of trusts. Possibly, to express this distinction, the expression “for the benefit of “ has been used, since the trustees, being the transferees, hold the property for the benefit of the unborn person.

In the case at hand the entire interest in the property goes to the benefit of the child to be born to Shri Rakesh Mohan. As the facts go to show, in fact a child was born in August, 1977. What would have happened if Rakesh Mohan did not get a male child is also spelt out in the trust deed.”

16. In light of the above observation it is clear that even if the property of the Trust was being held for the benefit of yet to be born persons it cannot be said that the requirement of Section 13(2)(h) read with Section 13(3) is not met. It cannot therefore be said that the shares held by the trustees were not for the benefit of anyone. It is clear from the trust deeds themselves that the beneficiary could be an unborn child but that does not by itself take it outside the purview of Section 13(2)(h) read with Section 13(3) of the Act.

17. Accordingly it is held that the three lakhs shares held by the trust were held by prohibited categories of persons in terms of Section 13(3) of the Act.

18. The last tranche is of 1,53,530 shares held by Shri Bakshi Sampuran Singh and his three sons. There is no dispute that Shri Bakshi Sampuran Singh, being the husband of the sister of Smt. Ram Rakhi, spouse of Shri Narender Mohan, falls within the meaning of 'relative' under Section 13. The only reason why the Tribunal appears to have accepted the contention of the Assessee that this share holding should not be included for the purposes of calculating the 20% share holding is that the spouse of the Assessee was no longer in that capacity after his death in 1969. In our view there can be no manner of doubt that the Tribunal has erred in coming to this finding. It is beyond comprehension how Smt. Ram Rakhi Mohan would cease to remain in the legal capacity of a spouse after the death of her husband.

19. Therefore, after adding back the two pieces of share holdings, that is, 3,00,000 shares held by the Trusts and the 1,53,530 shares held by Shri Bakshi Sampuran Singh and his three sons, the total shareholding of prohibited person in MBBL would be greater than 20% of the total paid up capital. The factual position therefore, is that the prohibited categories of persons hold a substantial interest in MBBL and, therefore, the dividend income of the Assessee Trusts cannot be exempted from tax in terms of Sections 11 & 12 of the Act.

20. Relevant to assessment year 1976-77, questions No. (2) and (3) are answered in the negative, that is, in favour of the Revenue and against the Assessee.

21. In regard to assessment year 1977-78 the position is more or less similar except that the actual figures of the share holding are different. Therefore, question (i) is answered in the affirmative, that is, in favour of the Assessee and against the Revenue. Question No.2 is answered in the negative, that is, in favour of the Revenue and against the Assessee.

22. The two references are therefore disposed of accordingly with no order as to costs.

S. MURALIDHAR, J

MADAN B. LOKUR, J

**OCTOBER 5, 2007
dn**