

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 06.07.2007

CORAM

THE HON'BLE MR.JUSTICE P.D.DINAKARAN
AND
THE HON'BLE MR.JUSTICE P.P.S.JANARTHANA RAJA

T.C.(A) Nos.520 to 522 of 2007

The Commissioner of Income Tax Coimbatore. ..Appellant in all T.Cs.

Vs.

M/s. KAY ARR Enterprises No.694 Avanashi Road

Coimbatore. ..Respondent in TC.520/07

R.Jayanthi ..Respondent in TC.521/07

K.Rajagopal (HUF) ..Respondent in TC.522/07

Appeals under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Madras 'D' Bench dated 26.7.2005 in ITA Nos.930, 928 and 931/Mds/2000 for the assessment year 1996-97.

For Appellant : Mr.J.Narayanasamy, Stg.Counsel for IT

J U D G M E N T

(Delivered by P.D.DINAKARAN,J.)

The Revenue has preferred the above tax case appeals against the common order of the Income Tax Appellate Tribunal dated 26.7.2005 made in ITA Nos.930, 928 and 931/Mds/2000, raising the substantial questions of law, viz.,

"(i) Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that the family arrangement as arrived by the assessee to rearrange the share holdings to avoid possible litigation themselves will not attract Capital Gains Tax under the Income-tax Act, 1961?

(ii) Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that, the re-arrangement of share holdings in the company to avoid possible litigation among family members to be a prudent arrangement, the same cannot be held as a transfer of shares which is exigible to Capital Gains Tax?"

under the following facts and circumstances of the case, which are common in all the three appeals.

2. The assessment year involved in these appeals is 1996-97. There was a transfer of shares between the assessee-firm, which consists of partners, who are family members, in that, certain new shares were acquired in exchange of old shares, as also some consideration in cash. According to the assessees, the transfer was consequent to a family arrangement. But, the Assessing Officer, after analysing the facts of the case and the legal aspects on the same, concluded that there was indeed a transfer involved and thus, subjected the Capital Gains Tax. Aggrieved by the same, the assessees filed appeals before the Commissioner of Income-tax (Appeals), who upheld the orders of the assessing officer. Exasperated by the same, the assessees preferred second appeals before the Tribunal and the Tribunal, by the impugned common order dated 26.7.2005, allowed the appeals on the ground that the re-arrangement of share holdings in the company to avoid possible litigation among family members is a prudent arrangement, which is necessary to control the company effectively by the major share holders to produce better prospects and active supervision and accordingly, held that such family arrangement cannot be held as transfer, which is exigible to Capital Gains Tax. Hence, the present appeals by the Revenue raising the substantial questions of law referred to above.

3. The core issue that arises for consideration in these appeals is whether the transfer of shares pursuant to the family arrangement to avoid a possible litigation among the family members would attract the Capital Gains Tax.

4. The law on the point is well settled by the decisions of the Apex Court in *Maturi Pullaiah and another v. Maturi Narasimham and others* [A.I.R. 1966 (SC) 1836], and in *Kale and Others v. Deputy Director of Consolidation and others* [A.I.R. 1976 (Supreme Court) 807] which are followed by this Court in *Commissioner of Income-tax v. Ponnammal* [(1987) 164 I.T.R. 706], and in *Commissioner of Income-tax v. AL.Ramanathan* [(2000) 245 I.T.R. 494]. It is a settled law that when parties enter into a family arrangement, the validity of the family arrangement is not to be judged with reference to whether the parties who raised disputes or rights or claimed rights in certain properties had in law any such right or not.

5.1. In *Maturi Pullaiah and another v. Maturi Narasimham and others* [A.I.R. 1966 (SC) 1836], cited supra, the Apex Court has held as follows:

"Briefly stated, though conflict of legal claims in praesenti or de futuro is generally a condition for the validity of a family arrangement, it is not necessarily so. Even bona fide disputes, present or possible, which may not involve legal claims will suffice. Members of a joint Hindu family may, to maintain peace or to bring about harmony in the family, enter into such a family arrangement. If such an arrangement is entered into bona fide and the terms thereof are fair in the circumstances of a particular case, courts will more readily give assent to such an arrangement than to avoid it."

5.2. In *Kale and Others v. Deputy Director of Consolidation and others* [A.I.R. 1976 (Supreme Court) 807], cited supra, the Apex Court has laid down the

propositions which are the essentials of a family arrangement and the same read as follows:

"(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.

5.3. This Court, in Commissioner of Income-tax v. Ponnammal [(1987) 164 I.T.R. 706], referred supra, held that,

"... the family arrangement had been brought about by the intervention of the panchayatdars and this clearly showed that the sons and daughters of the assessee were laying claims to the property which the assessee got under the will of her father and it was not relevant at the time when the family arrangement was entered into to find out as to whether such claims if made in a court of law would be sustained or not. If the assessee found it worthwhile to settle the dispute between herself, her sons and daughters by making the family arrangement, the said arrangement could not be ignored by a tax authority. In view of the finding of the Tribunal, the family arrangement dated December 17, 1971, had to be held to be a valid piece of document and, hence, the Tribunal was right in its view that no transfer of property was involved within the meaning of section 2(xxiv) of the Gift-tax Act and, hence, there was no liability to gift-tax either under section 4(1)(a) or under section 4(2) and consequently no question of inclusion of the income of the minor in the hands of the assessee would also arise."

Accordingly, in the said case, applying the principles laid down in the decisions of the Apex Court and the decision of this Court referred supra, this Court held as follows:

"The Tribunal, on the facts, found that the family arrangement involved in this case appears to be a bona fide one inasmuch as it has been shown to have been made voluntarily and not induced by any fraud or collusion and the conduct of the parties referred to by the Revenue is consistent with the bona fide family arrangement particularly when it was arrived at in the presence of panchayatdars. So, the family arrangement is a bona fide one and it was effected to dissolve the family dispute.

6.1. In the instant case also, the Tribunal found that the re-arrangement of shareholdings in the company to avoid possible litigation among family members is a prudent arrangement which is necessary to control the company effectively by the major share holders to produce better prospects and active supervision or otherwise there would be continuous friction and there would be no peace among the members of the family. Such a family arrangement intended either by compromising doubtful or disputed rights or by preserving the family property or the peace and security of the family by avoiding litigation or by saving its honour cannot be concluded as any other dealings between

strangers, as such a family arrangement is for the interest of the family and for the harmonious way of living. Therefore, such a re-alignment of interest by way of effecting a family arrangement among the family members would not amount to transfer.

6.2. Hence, the Tribunal has rightly found that the impugned transfer of shares by way of family arrangement would not attract Capital Gains Tax, as the same is a prudent arrangement to avoid possible litigation among the family members and is made voluntarily and not induced by any fraud or coercion and therefore, cannot be doubted.

In view of the settled propositions of law, we hold that the Tribunal was justified in arriving at the conclusion that the family arrangement among the assesseees does not amount to any transfer and hence, not exigible to capital gains tax. Accordingly, finding no substantial question of law arises for our consideration in these appeals, the same are dismissed. Consequently, connected miscellaneous petitions are also dismissed.

To

1. The Assistant Registrar
Income Tax Appellate Tribunal
"D" Bench
Madras.
2. The Secretary
Central Board of Direct Taxes
New Delhi.
3. The Commissioner of Income Tax (Appeals)
Coimbatore.
4. The Joint Commissioner of Income tax
Special Range I
Coimbatore.